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Subject Comment to Proposed Amendments to Rules 16, 26, 33, 34,
37, and 45

Annexed is the comment letter of Zwerling, Schachter & Zwerling, LLP, with one exhibit. Thank you for your consideration of our comments.

Hillary Sobel, Esq.

Zwerling, Schachter & Zwerling, LLP

41 Madison Avenue, 32nd Floor

New York, NY 10010

Telephone: (212) 223-3900

Facsimile: (212) 371-5969

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Amended R&R 7-16-04.pdf



Comment Letter.doc

Counselors at Law

41 Madison Avenue
New York, NY 10010
Telephone: 212-223-3900
Facsimile: 212-371-5969

50 Charles Lindbergh Blvd.
Suite 501A
Uniondale, NY 11553
Telephone: 516-832-9600
Facsimile: 516-832-9605

1904 Third Avenue
Suite 1030
Seattle, WA 98101
Telephone: 206-223-2053
Facsimile: 206-343-9636

ZWERLING, SCHACHTER & ZWERLING, LLP

Susan Salvetti
Robert
Schachter
Richard A. Speir
Jeffrey
Zwerling
Robin F. Zwerling

Stephen L. Brodski
Shaye J. Fuchs
Paul Kleidman
Kevin M. McGee
Anthony F. Prisco
Sona R. Shah
Hillary Sobel
Justin M. Tarshis

Of Counsel
Dan Drachler *
Joseph Lipofsky
Joseph S. Tusa

* Also Admitted
in Washington

February 15, 2005

BY E-MAIL

Mr. Peter G. McCabe,
Secretary of the Committee on
Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE
Washington, DC 20544

Re: Proposed Amendments to the Federal Rules of Civil Procedure

Dear Mr. McCabe:

Zwerling, Schachter & Zwerling, LLP, has an extensive practice in the representation of consumers and investors in class actions, concentrating in the areas of securities, consumer fraud, and antitrust. Recent litigation experiences by our firm inform these comments, most notably *Hayman v. PricewaterhouseCoopers LLP*, 1:01 CV 1078 (N.D. Ohio) (O'Malley, J.).¹ It is from

¹ We have annexed for the convenience of the Committee a copy of the Amended Report & Recommendation ("R&R") issued by Magistrate Judge Hemann on July 16, 2004, recommending the entry of default judgment as a sanction for discovery abuses committed by PricewaterhouseCoopers LLP ("PwC"). The R&R addresses numerous issues pertinent to any consideration of the proposed amendments, including among others: the differences between hard copies and electronic data (R&R at 18-19), the necessary standard against which a responding party's conduct must be judged before imposing (footnote cont'd on next page ...)

Peter G. McCabe
February 15, 2005
Page 2

this perspective that the firm respectfully submits these comments to the proposed amendments to Fed. R. Civ. P. 16, 26, 33, 34, 37 and 45.

INTRODUCTION

Judge Kocoras of the Northern District of Illinois put it simply: "Discovery is a search for the truth." *Shapo v. Engle*, 2001 WL 629303 at *2 (N.D. Ill., May 25, 2001) (Kocoras, J.). Technology ought to promote rather than frustrate that search. Yet, the comments to the proposed rules, and indeed, the wording of some of the proposed amendments may, in fact, frustrate that search.

Overall, electronic discovery is no more difficult than traditional paper discovery; indeed, it has offered far easier options to litigants and their counsel, in terms of time, money, and accuracy. The costs about which large corporations and their counsel protest do not offer comparison to the costs of hard copy production. The emergence of e-discovery businesses, which profit from the lack of time and knowledge lawyers have to devote to understanding electronic media, does not automatically translate to an increased cost of discovery. Reviewing file cabinets filled with paper always required an enormous amount of time – first for responsiveness to discovery requests; then for privilege. Warehouses stored hundreds upon thousands of documents, often un-indexed. Litigants had photocopy costs, and Bates numbering services. Technology has not imposed new costs on litigants, or even greater costs. It has instead re-tooled the very same tasks using technological advances. As one court recently noted:

By contrast, computer technology affords a variety of methods by which the government may tailor a search to target on the documents which evidence the alleged criminal activity. These methods include limiting the search by date range; doing key word searches; limiting the search to text files or graphics files; and focusing on certain software programs. Of course, these are not the exclusive means of focusing a computer search, and they are not the means that might be appropriate in every case. But, the existence of these tools demonstrates the ability of the government to be more targeted in its review of computer information than it can be when reviewing hard copy documents in a file cabinet.

In the Matter of the Search of: 3817 W. West End Avenue, First Floor, Chicago Illinois 60621, No. 04

sanctions (*id.* at 47-50, 66-67), and the duty to preserve documents both before and during the pendency of litigation (*id.* at 67-68). PwC has objected to the R&R, its objections are *sub judice*. We will provide updates to the Committee upon receipt of the ruling by the District Court judge.

Peter G. McCabe
February 15, 2005
Page 3

M 108, 2004 WL 1380272 (N.D. Ill. May 27, 2004) (citation omitted; footnote omitted).

In an effort to adapt the rules to emerging issues and technology, we ask the committee to keep in mind certain key points that underlay discovery in the Age of Technology:

First, the proposed amendments to the Federal Rules necessarily apply equally in small cases and complex matters, individual actions and class actions, between parties of equal bargaining power and size, and unequal parties. Yet, as drafted, the proposals seem tilted to allow large parties unilaterally to restrict relevant discovery, an area that has always fallen within the sole purview of the courts.

Second, the vast majority of documents created today are in *electronic form*. Thus, all parties should now expect the involvement of some electronic discovery. The suggestion that parties might “not anticipate discovery of electronically stored information” ought not to be a statutory exception. See *Report of the Civil Rules Advisory Committee* (“Report”) at 7; see also Committee Note to Rule 16(b) at 3; see also Committee Note to Rule 26(f) at 17. A bar to such discovery flies in the face of the purpose of the discovery process. As PricewaterhouseCoopers LLP (“PwC”) has advised the general counsel of its clients:

Many lawyers don't realize that the way they receive, review, and catalogue electronic documents allows them access to information that they would not otherwise have via the traditional paper method....The key to any litigation, or any research, is to have all of the available information.

See Peter Vakof (V.P. Dispute Analysis & Investigations, PwC), *Electronic Discovery – The Key to Hidden Data*, General Counsel Forum, May – June 2002 (PricewaterhouseCoopers) (“*Electronic Discovery – The Key to Hidden Data*”) at 2.

Finally, one much needed proposal that will deter waste and reduce the overall cost in litigation – to litigants, their counsel, and notably the courts – is the early discussion and identification of systems in use, as proposed Rules 16(b)(5) and 26(f)(3) suggest. These proposals serve the beneficial purpose of focusing the scope of discovery at the earliest stages of litigation. However, early disclosure ought to be mandated by including information about electronically maintained data in the Rule 26(a) automatic disclosure requirements. Currently, the proposal leaves it to the parties in consultation with the court to determine if such disclosures need to be made. Moreover, because some statutes, such as the PSLRA and the Bankruptcy Code, have automatic stay provisions, the Committee should include guidance in the Notes that early disclosures addressing electronic discovery should be made notwithstanding a stay of discovery, to ensure both that discovery is not lost during the stay, and that discovery can

Peter G. McCabe
February 15, 2005
Page 4

proceed efficiently upon lifting the stay. Such guidance is of particular import in our practice, as discovery delays can mean discovery permanently lost.

METHOD OF PRODUCTION – PROPOSED RULES 26(B)(2) AND 34

The Committee specifically has requested comments to address particular issues pertaining to the proposed amendments to Rule 34: “whether Rule 34 itself or the Note should specifically state that a responding party should not avoid reviewing and producing electronically stored information because a production request did not separately seek it...” (Report at 16) and “whether the proposed options for production of electronically stored information are suitably analogous to the existing options for production of hard-copy materials.” *Id.* We believe that these issues tie directly not only to the amendments proposed for Rules 26(b)(2) and 34, but overall as to how parties view their discovery obligations.

The proposed amendment to re-define “documents” in Rule 34(a) reflects a desire by the Committee to codify the courts’ recognition over the last decades that “documents” include electronic data. The inclusion of sampling electronic data is an option whose time is welcome. It may, in many instances, foreclose the need for expensive and time-consuming motion practice. Indeed, by including this option to “test, or sample any designated electronically stored information ...,” the question of whether the data is truly inaccessible will resolve itself. Indeed, as time marches on, and technology advances, the question of what data is accessible or not will wither away.²

The proposed amendments also consider allowing a responding party to object to a chosen, proper method of production – or giving the responding party the option of how to produce responsive electronic discovery. In so doing, the proposal returns discovery to a game of chance, something the Rules have long sought to eliminate. Indeed, the current proposal to amend Rule 34(b) may defeat the very purpose of seeking discovery in electronic rather than paper form if the responding party may unilaterally refuse to produce discovery in electronic format even where it maintains that information electronically in the ordinary course of business. See Committee Note at 30. This possibility eviscerates the very rationale for the 1980 amendments. As Judge Shadur noted in *Board of Education v. Admiral Heating & Ventilating, Inc.*, 104 F.R.D. 23 (N.D. Ill. 1984):

² The irony of Microsoft complaining about the complexities of the electronic world ought not to be lost on this Committee.

Peter G. McCabe
February 15, 2005
Page 5

That the option afforded by Rule 34(b) as amended [for discovery either by category or as maintained in the ordinary course of business] no longer belongs exclusively to defendants is beyond serious doubt. Otherwise the very purpose of the 1980 amendment would be thwarted.

Id. (citation omitted). The court reasoned that the “amendment was aimed at forestalling such abuses as the deliberate mixing of ‘critical documents with others in the hope of obscuring significance.’” *Id.* at 36 (citing Rule 34, Advisory Committee Note to Subdivision (b) (1980 Amendment)). As one commentator noted on the eve of the 1980 Amendments:

Another prevalent discovery abuse occurs where a party is requested to produce documents and produces a disorganized, shuffled pile of papers, saying, in affect, “Good Luck! It’s in there somewhere; you find it.” The proposed amendments seek to remedy this by requiring production “in the order in which the documents are kept in the usual course of business.” In that way, *there should be an internal logic to the document production reflecting business use.* [Emphasis added; citation omitted.]

W. Erickson, *The Pound Conference Recommendations: A Blueprint for the Justice System in the Twenty-First Century*, 76 F.R.D. 277, 289 (1978). The proposed amendments to Rule 26(b) and 34(b) eviscerate this laudable goal.

Invoking the definition of the newly defined “documents” in other proposed amendments is where certain problems arise, notably as to what is “not reasonably accessible” under the proposed amendment in Rule 26(b)(2). The central problem is that the responding party is the sole arbiter, forcing the requesting party to move to compel without sufficient knowledge about those documents claimed not to be readily accessible. The requesting party lacks information about why documents are not readily accessible or even which types of documents fall within this “protected” category. The Advisory Committee Note at 13 and the Report at 11 seem unclear as to whether a court order is needed before a responding party must identify what information it deems not reasonably accessible. Currently, a requesting party has more information about challenging an assertion of privilege than in challenging a designation of “reasonably inaccessible.”

Metadata should not fall within the scope of not reasonably accessible, as the Notes indicate. See Committee Note to Subdivision (b)(2) at 14. Similarly, the Rules ought not to countenance the stripping by a party of metadata before producing documents, and the Notes appear to suggest such conduct is permissible. Metadata operates much like a routing slip did when people type memoranda for distribution through the office. It identified to whom the

Peter G. McCabe
February 15, 2005
Page 6

author distributed the memo, the recipient's initials indicated the recipient's review, and maybe the date. When file personnel cataloged the memo, the routing slip remained attached. In the days of paper production, a party could not permissibly detach the routing slip from the memorandum. Why then should the routing slip's electronic counterpart – metadata – be treated differently? Indeed, corporations know the value and utility of metadata in both prosecuting and defending against litigation:

The most obvious advantage to documents delivered in electronic format is that they have metadata preserved, revealing information about when, and by whom, a document was created and whether it has been modified. This type of information can be invaluable in preparation for litigation. For example, one can confirm whether a document is created in the ordinary course of business or whether the creation/modification date suggests otherwise (i.e. created in contemplation of litigation).

Electronic Discovery – The Key to Hidden Data, at 2. PwC has suggested to its clients how to tackle this very issue – and the advice is not to ignore metadata, but rather to:

1. Identify all potential sources of information

Just as you would in a paper-based search, you must ensure that all of the relevant data is readily available to all associated parties in the litigation. Although your clients might save all of their electronic data on a server, finding potentially all relevant data is often best left to an outside service provider. In many instances, while the focus is placed on the file/e-mail servers, the related parties' computers or personal data assistants ("PDAs") are ignored. Many companies can equip lawyers with the tools and expertise to implement electronic discovery. These tools can assist in identifying various sources of data, as well as, capturing and converting them into a searchable and readable format while maintaining the integrity of the original documents. This exercise includes potential recovery of hidden and deleted data.

Id. at 3.

A related issue arises once a responding party has unilaterally deemed certain material "inaccessible": it may well destroy it, despite its relevance, readily subverting its duty to preserve documents. See e.g., *Zubulake v. UBS Warburg LLC*, 212 F.R.D. 212, 217 ("Zubulake IV") (addressing the duty to preserve back-up tapes). Indeed, parties have raised complaints about the complexity of computer systems, leading to a purported inaccessibility of data. Yet, but for disaster recovery systems (themselves evolving from to remote, daily backup systems), businesses

Peter G. McCabe
February 15, 2005
Page 7

do not organize their computer servers like a giant garbage dump, but dedicate different servers by department or use. E-mail servers are but one common example of separate, dedicated servers. Documents, even in paper, that were located in far-flung offices, if relevant, still needed to be produced. Parties have often complained that e-discovery is simply "too burdensome." The proposed Rule will now provide a statutory out using the shorthand "not reasonably accessible."

An example our firm faced in one case illustrates the problem of providing an excuse from production: We previously faced circumstances where a defendant was engaged in merger discussions during litigation, although prior to the commencement of discovery. No preservation order existed, and so we requested that documents be preserved during the merger process. Much later in discovery, we learned that, as a consequence of the merger, certain computer systems were changed rendering data in existence at the time of the action's commencement difficult to obtain, possibly in the parlance of the proposed rule "not reasonably accessible." Should a requesting party be hamstrung in such circumstances? Of course not. But the proposed Rule forces a requesting party to move to compel, and be forced to incur costs and attorneys' fees as a consequence. A balance must be struck without giving a producing party an easy out. Courts have shown time and again that they are more than up to the task of sorting out these disputes.

We answer the Committee's questions by respectfully quoting the court in *Bratka v. Anheuser-Busch Co., Inc.*, 164 F.R.D. 448, 463 (S.D. Ohio 1995): "If litigants are to have any faith in the discovery process, they must know that parties cannot fail to produce highly relevant documents within their possession with impunity. Parties cannot be permitted to jeopardize the integrity of the discovery process by engaging in halfhearted and ineffective efforts to identify and produce relevant documents."

PRIVILEGE/WAIVER – PROPOSED RULES 16(B)(4), 26(B)(5), AND 26(F)(4)

The asserted problems in conducting a privilege review of electronic data are exaggerated. The search capabilities in computer programs today render privilege reviews faster, easier, and more accurate than manual review of rooms full of boxes, or tiers upon tiers of file cabinets. *Contra* Committee Note at 19-20.³ Computers can search by names of legal personnel,

³ Metadata, however, cannot fall within the parameters of privileged communications. The computer automatically creates metadata as a way of ordering its data for retrieval purposes. Thus, the predicates of attorney-client privilege simply do not exist; only "[c]onfidential disclosures by a client to an attorney made in order to obtain legal assistance are privileged." *Fisher v. United States*, 425 U.S. 391, 96 S.Ct. 1569, 1577, 48 L.Ed.2d 39 (1976). Metadata, colloquially referred to as data about data, shows who reviewed a document and when. It does not constitute a communication, let alone a confidential one. (footnote cont'd on next page ...)

Peter G. McCabe
February 15, 2005
Page 8

designations to reflect the assertion of a privilege, dates, and key terms. *Accord*: Solovy, Jerold S. and Byman, Robert L. "Discovery in the E-Age," *The National Law Journal* (March 15, 2004) ("Give 10 lawyers 10 days to look at 10 million documents to find 10 privileged documents, and we predict they will miss one. Give one computer technician one hour to search 10 million documents and he will find all 10, every time."). Thus, technology renders "quick peek" and "claw back" agreements unnecessary.

Privileges constitute an exception to the rules of discovery. *Fisher v. U.S.*, 425 U.S. at 403. Privileges clearly impede the search for truth and reduce the amount of information that may be discovered. *Trammel v. U.S.*, 445 U.S. 40, 50-51 (1980). The proposed rules should not expand their use and manipulation by enshrining "quick peek" and "claw back" agreements into the Rules.

As the Committee knows, an entire body of law has developed regarding what constitutes inadvertence and the steps undertaken to ensure that no privileged document slipped through. Rules 16(b)(5), 26(b)(5), and 26(f)(4), as proposed eviscerate a party's obligation to preserve privilege, and instead shift the burden from the proponent of the privilege to its challenger. See e.g., Committee Note to Rule 26(b)(5) at 16. While the Rule attempts to avoid eliminating all privilege waivers by requiring that the "claw back" be made within a reasonable time, it assumes that a producing party re-reviews the universe produced within such time. See Committee Note to Rule 26(f) at 21 (suggesting that a reasonable time is "perhaps thirty days from production.") What if, as is more likely the case, the producing party does not look at the documents again until depositions are scheduled? May he claw back the purportedly privileged document? What if the responding party has already used the document in preparing her litigation strategy? What then? When is the privilege deemed waived?⁴

SANCTIONS – PROPOSED RULE 37(F)

Indeed, the information reflected in metadata constitutes objective facts, similar to those that most courts require disclosed on a privilege log. *Upjohn v. U.S.*, 449 U.S. 383, 396 (1981). As to work product, if a computer creates metadata, how can that fall within the traditional exclusion from discovery of opinion work product as defined in *Hickman v. Taylor*, 329 U.S. 495, 510-511, 67 S.Ct. 385, 393, 91 L.Ed. 451 (1947)?

⁴ Indeed, the Note to Subdivision (b)(5) reflects some of the factors courts traditionally consider in assessing inadvertent waiver. See Committee Note at 15.

Peter G. McCabe
February 15, 2005
Page 9

The proposed amendment to Rule 37 has the following consequences:

First, it embodies the exaggerated fears articulated in some of the comments, not the least of which is Microsoft's suggestion that spam filters, which routinely operate to destroy electronic junk mail, will result in sanctions.

Second, it assumes that no routine operation of computers can be or should be altered. There is a distinct difference between setting defaults to delete or archive e-mail after a specified period of time (say 90 days), and defragging⁵ a desktop to allow it to run more efficiently. By treating all "routine" operations as identical and inalterable, the Committee has rendered otherwise relevant and discoverable information "not readily accessible" under proposed Rule 26(b)(2) without the need for a showing that the routine need not have continued. (By falling within the rubric of "not reasonably accessible," it becomes costly to restore and, in practical effect, may be lost forever from discovery even if relevant.)

Third, the proposal's requirement of a preservation order *prior* to the imposition of sanctions erects new barriers to sanctioning misconduct. The predicate of an order for any sanction under rule 37 is now reflected only in Rule 37(b); other paragraphs of Rule do not require an order, nor does Rule 26(g). Moreover, the Supreme Court has recognized the inherent authority of district courts to impose sanctions for a wide range of abuses. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991). The new requirement imposes limits on a court's inherent authority.

Furthermore, the precondition of a preservation order ignores the unfortunate yet fundamental realities in litigation:⁶ responding parties often refuse to consent to the entry of a preservation order, and courts often rest their faith in the duty of counsel as an officer of the court and deny requests for preservation orders absent some compelling evidence. By then, of course, it may be too late, as we found out in our case, *Hayman v. PricewaterhouseCoopers*. Only after all merits discovery concluded, and after expert discovery concluded, and after PwC filed summary judgment did we learn that all discovery (electronically maintained) had not been

⁵ Defragging is an operation performed by the computer that realigns fragments of data, akin to moving files in a file drawer to eliminate dead space resulting from deleting files. By reorganizing the fragments of data so that they are contiguous to one other, the computer can more quickly identify the data for retrieval.

⁶ We recognize that the Committee has included in the Note to proposed Rule 37(f) that the amendment does not speak to a party's duty to preserve documents prior to the commencement of an action. Note at 34. See e.g., *Zubulake IV*, 220 F.R.D. at 217-218.

Peter G. McCabe
February 15, 2005
Page 10

produced, and indeed, PwC admitted to having destroyed or altered documents that Class Plaintiffs did not have, including e-mail under its regular document destruction policies. PwC repeatedly told the parties and the Court that it had produced everything. So, to what end would Class Plaintiffs have needed an order?⁷ Of course, the falsity of PwC's representations became manifest. *See generally*, R&R.

The alternative proposal reflected in the footnote to proposed Rule 37(f)(2) to limit sanctions to only intentional or reckless misconduct narrows rather than codifies existing law. Courts have recognized the propriety of sanctions for discovery abuse whether the misconduct resulted from willfulness, bad faith, or fault. *See e.g.*, *Regional Refuse Systems, Inc. v. Inland Reclamation Co.*, 842 F.2d 150, 154 (6th Cir. 1988); *Melendez v. Illinois Bell Telephone Co.*, 79 F.3d 661, 671 (7th Cir. 1996); *Residential Funding Corporation v. DeGeorge Financial Corporation*, 306 F.3d 99, 108 (2nd Cir. 2002). Courts have readily fashioned a wide range of sanctions depending upon the extent of the misconduct at issue. *See generally*, *Metropolitan Opera Ass'n, Inc. v. Local 100, Hotel Employees and Restaurant Employees Int'l Union*, 212 F.R.D. 178, 222 (S.D.N.Y. 2003). Proposed Rule 37(f) would weaken the courts' powers to admonish misbehaving litigants.

If the Committee elects to amend the Rules now, we recommend that it take the following steps:

(1) Amend Rule 26(a) to incorporate among the automatic disclosures, information about electronically maintained data, including, but not limited to, the matters contemplated by early disclosures in proposed Rules 16(f) and 26(f):

- (a) Number, types and locations of computers (including desktops, laptops, PDAs, cell phones, etc.) currently in use and no longer in use;
- (b) Past and present operating system and application software, including dates of use and number of users;
- (c) Name and version of network operating system currently in use and no longer in use but relevant to the subject matter of the action;
- (d) Backup and archival disk or tape inventories/schedules/logs;
- (e) Backup rotation schedules and archiving procedures, including any automatic data recycling programs in use at any relevant time;
- (f) Electronic records management policies and procedures; and

⁷ The court *sua sponte* entered a preservation order after the parties sought leave to file their sanctions motions.

Peter G. McCabe
February 15, 2005
Page 11

- (g) Most likely locations of electronic records relevant to the subject matter of the action.

This additional information will allow the parties to better plan and execute discovery.

(2) Require a responding party that asserts documents are “not reasonably accessible” to provide a log – at the time it serves the discovery response – detailing:

- (a) the types or categories of documents not reasonably accessible;
- (b) the location of those documents not reasonably accessible;
- (c) the reason those documents are not reasonably accessible;
- (d) when those documents not reasonably accessible became so;
- (e) the person(s) responsible for those documents not reasonably accessible;
and
- (f) the computer requirements (both hardware and software) necessary to render the documents reasonably accessible.

Peter G. McCabe
February 15, 2005
Page 12

We thank the Advisory Committee on Civil Rules for this opportunity to be heard on a matter of great import in the ever-developing arena of electronic discovery. If we can be of any further assistance, we stand ready to do so.

Respectfully submitted,

/s/ Robin F. Zwerling
Robin F. Zwerling

/s/ Hillary Sobel
Hillary Sobel

RFZ/hs
Attachment

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE: TELXON CORPORATION)	
SECURITIES LITIGATION)	CASE NO. 5:98CV2876
_____)	
WILLIAM S. HAYMAN, et al.,)	CASE NO. 1:01CV1078
)	
(Plaintiffs,)	
)	JUDGE O'MALLEY
v.)	
)	MAGISTRATE JUDGE HEMANN
PRICEWATERHOUSECOOPERS, LLP,)	
)	AMENDED REPORT AND
Defendant.)	RECOMMENDATION ¹
)	Docket # 288 (5:98CV2876)
)	Docket # 150 (1:01CV1078)

This case is before the magistrate judge on referral. Before the court is the motion of third-party plaintiff, Telxon Corporation ("Telxon"), for sanctions against third-party defendant, PricewaterhouseCooper, LLP ("PwC") ("Tel. mot."; Docket #288 (5:98CV2876)). Also before the court is the motion of class plaintiffs, William S. Hayman and Arthur M. Hayman ("plaintiffs"), for sanctions against PwC ("Pl. mot."; Docket #150 (1:01CV1078)). PwC opposes both motions ("Def. opp."; Docket #163 (1:01CV1078)). For the reasons given below, the magistrate judge recommends that the motions be granted and that the court enter default judgment on liability against PwC and in favor of Telxon and plaintiffs.

¹ Counsel for plaintiffs and Telxon Corporation wrote the court to point out errors in dates and various typographical errors in the original Report and Recommendation. The court has made these corrections and corrected other typographical errors. The corrections do not alter the substance of the magistrate judge's Report and Recommendation.

I.

Plaintiffs filed an action against Telxon on December 11, 1998 for alleged violations of §§ 10(b) & 20(a) of the Securities and Exchange Act of 1934. That same day Telxon restated its accounting treatment of its largest transaction of the prior quarter. Telxon further announced on February 23, 1999 that it would restate its audited financial statements for fiscal years 1996, 1997, and 1998 and restate the unaudited financial statements for the first two quarters of fiscal 1999.

On February 22, 1999 PwC received a subpoena from the Securities and Exchange Commission ("SEC") requesting some documents related to its audit of Telxon. On March 10, 1999 Alan S. Fox ("Fox"), an attorney in the Office of the General Counsel for PwC, issued a memorandum to Daniel Cola ("Cola"), the PwC "engagement partner" on the Telxon account, "that all materials relating to prior annual or quarterly work of Telxon, including desk files, personal files, or documents from any other source, must be preserved." Declaration of Fox, Appendix of Exhibits IA (Docket # 310), Exh. E, p. 2. On August 19, 1999 the SEC served a second subpoena on PwC requesting Telxon-related documents. Together the two subpoenas from the SEC requested the audit and review papers related to Telxon's financial statements for fiscal years 1996, 1997, 1998, and 1999 and all papers related to Telxon's restatements. PwC gave the job of assembling documents to comply with the SEC subpoena to Cola, who in turn delegated the task to Grant Hellwarth ("Hellwarth"), the manager of the Telxon account. On March 10, 1999 staff legal counsel for PwC issued a memorandum to preserve Telxon-related documents.

Plaintiffs amended their complaint against Telxon on September 30, 1999. Telxon

moved to dismiss the complaint, and the court denied this motion. On November 16, 1999 plaintiffs moved to lift the stay on discovery in the Telxon action as to non-party PwC. The court denied this motion on February 10, 2000. Discovery began in the Telxon action in late October 2000.

On November 10, 2000 plaintiffs served a subpoena on PwC requesting production of all audit and review workpapers for the years ending March 31, 1996; March 31, 1997; March 31, 1998; and March 31, 1999. In response to this subpoena and by agreement with Telxon and plaintiffs, PwC produced on January 2, 2001 the hardcopy documents it had already produced to the SEC in response to the SEC's subpoena.¹

On February 20, 2001 Telxon filed a third-party complaint against PwC. Telxon alleged that PwC had consciously disregarded the risk that Telxon's financial statements might contain material errors, had failed to conduct audits and interim reviews in accordance with generally accepted accounting principles, and fraudulently forced Telxon unnecessarily to restate its financial statements for 1996, 1997, 1998, and the first two quarters of 1999. Telxon sought damages pursuant to theories of contribution, accountant malpractice, fraud, constructive fraud, fraudulent concealment, fraudulent misrepresentation, negligent misrepresentation, breach of contract, and breach of fiduciary duty. On May 3, 2001 plaintiffs filed a separate action against PwC, alleging PwC's participation in Telxon's alleged fraudulent conduct. These two actions and another action against Telxon were subsequently consolidated on April 23, 2003. See Memorandum and

¹ The SEC subpoena had requested the audit and review workpapers for the same fiscal years as plaintiffs' subpoena.

Order, April 23, 2003 (Docket #166 (5:98CV2876)).

On February 20, 2002 Telxon served on PwC its first request for the production of documents. This request sought, *inter alia*, all communications and documents related to Telxon's restatements of earnings. On March 25, 2002 PwC responded as follows:

PwC previously produced all of its workpapers for its audits of Telxon's financial statements for the fiscal years ended March 31, 1996, March 31, 1997, March 31, 1998, and March 31, 1999. Among other things, these documents include PwC's workpapers for the MRK restatement, the February restatement, and Telxon's other three restatements of its financial statements. The documents were produced by PwC in response to Plaintiffs' subpoena duces tecum dated November 8, 2000 (served November 10, 2000). In addition, PwC also has produced numerous other documents relating to its work for Telxon in response to that subpoena.

Although these documents were produced in response to Plaintiffs' subpoena, and before PwC became a party to this proceeding, all of the documents also were produced to Telxon. Reproducing these documents now would be completely duplicative and unduly burdensome to PwC. Accordingly, PwC will not provide the same documents that were produced to Telxon.

Third-Party Defendant PricewaterhouseCoopers LLP's Response to Third-Party Plaintiff Telxon Corporation's First Request for Production of Documents, Appendix to Affidavit of Jon J. Pinney, Vol. 1 ("Pinney app. 1"; Docket #293); Exh. 5, p. 1. The response claimed that PwC had already produced all relevant documents or that Telxon was seeking documents protected by attorney-client privilege or the work product doctrine. The response was not accompanied by any new documents.

Telxon again requested all responsive documents from PwC on April 18, 2002. Telxon specifically requested internal guidance documents outlining audit and interim review policies and procedures, the work history and experience of PwC's engagement staff, internal communications, the working files of all members of the engagement team, and all computer software used by PwC in its audits and reviews. Telxon also claimed that

some workpapers and e-mails appeared to be missing from PwC's previous production. PwC responded to this request by letter on April 26, 2002, asserting that all of these documents had been produced as PwC maintained them in the ordinary course of business. The letter added, "This production completely satisfies PwC's obligations under the Federal Rules and we do not intend to produce these documents for a second time nor comply with the onerous obligations that [Telxon] seeks to impose in [its] letter." Letter of Nicholas I. Porritt ("Porritt") to Drew Carson ("Carson"), April 26, 2002; Pinney app. 1; Exh. 8, p. 1. PwC's letter did say, however, that "[t]here is a relatively small amount of additional documents that we shall be producing shortly. When that supplemental production has been made, PwC's production will be complete." *Id.* The letter specifically refused to provide internal guidance documents, electronic databases, or audit software. PwC denied that any non-privileged workpapers or e-mails were missing from its previous production.

On May 10, 2002 Telxon wrote PwC asking that PwC provide workpapers related to PwC's quarterly reviews during the relevant years as well as the year-end audits, workpapers related to the fiscal year 2000 financial statement insofar as those papers concerned the previous years' audits, and documents regarding PwC's internal audits of Telxon. Telxon again requested PwC's electronic databases and programs.

On May 17, 2002 PwC served on Telxon its initial disclosures. Pinney app. 1, Exh. 10. PwC again assured Telxon that it had produced all of its workpapers for the fiscal years at issue, including the workpapers related to Telxon's restatements, in response to plaintiffs' subpoena of November 2000. PwC added, "In addition, PwC has also produced numerous other documents relating to its work for Telxon in response to the Subpoena.

Finally, PwC is in the process of producing relevant documents, to the extent they were not produced previously in response to the Subpoena, in response to Plaintiffs' Request for Production of Documents dated February 27, 2002" *Id.* at 16.

Counsel for Telxon and PwC met on May 30, 2002 to discuss Telxon's dissatisfaction with PwC's production of discovery items. On June 7, 2002 PwC sent Telxon a letter stating, "Following PwC's modest supplemental production today, PwC will have produced all documents responsive to [Telxon's] requests." Letter of Porritt to Carson and Karla L. Bell ("Bell"), June 7, 2002; Pinney app. 1; Exh 13, p. 1.²

On June 11, 2002 Telxon submitted to the court a description of its perceived failures by PwC properly to comply with Telxon's discovery requests and requested a conference to resolve discovery disputes between it and PwC. Pinney app. 1, Exh. 14. PwC's letter to the court in response declared, "The documents produced to Telxon in February 2001 include all of PwC's audit workpapers for the audits of Telxon that are in issue in this litigation, the personal desk files of the PwC auditors, the workpapers for additional projects for Telxon, and other communications between PwC and Telxon." Letter from Pete C. Elliott ("Elliott") to Patricia A. Hemann, June 24, 2002 ("June 24, 2002 letter"); Appendix to the Affidavit of Pinney, Vol. 2 ("Pinney app. 2"; Docket #294

² The letter referred specifically to Telxon's document requests 1-21, 24-28, 30-31, 33-35, 41-42, 44-45, 55-56, 58, 60, 62, 65-70, 73-81, 84, 90, 92-93, and 95-97. PwC either objected to the production of other requested documents or, in the case of requests 37 and 38, promised to produce the documentation standards for the preparation and maintenance of PwC's workpapers. PwC specifically objected to producing documents "reflecting procedures to be followed in the situation of a client restating its financial statements or becoming the subject of an SEC inquiry, NASDAQ investigation or litigation" *Id.* at 1-2.

(5:98CV2876)); Exh 15, p. 1. PwC assured the court that it "has now produced all documents it believes are responsive to Telxon's requests." *Id.* at 2. PwC claimed that it "has produced all non-privileged documents . . . showing procedures that were actually performed with regard to Telxon's financial statements and Telxon's restatements" *Id.* at 3. In a hearing before the court, Magistrate Judge Hemann found that the materials requested by Telxon related to internal guidance were discoverable materials, although not necessarily materials which could be used at trial. Transcript of Proceedings, June 26, 2002; Pinney app. 2; Exh 17, p. 5. The court also found:

[T]o the extent there are references to work papers, to policies, then indeed you will produce those manuals. And in addition to that, I want you to prepare a list that would satisfy this production. I want . . . [Telxon and plaintiffs] to be able to look at it and the three of you negotiate and work on what should be turned over.

Id. at 14. The court cautioned against a fishing expedition but added that parties "are certainly allowed to have material that may lead to relevant material." *Id.*

At the hearing PwC expressed concern that Telxon's experts would be given access to PwC's internal guidance materials and might later be hired as consultants by PwC's competitors. In response the court stated:

I certainly assume that anyone who looks at those will appropriately sign off on the confidentiality agreement. And I don't have as much concern with the consulting expert as the testifying expert. I think as you get to the point, if you get to the point, where you find the testifying expert is someone who is an active competitor of PwC, you might want to raise this issue again.

Id.

Telxon sent PwC a letter on July 24, 2002 identifying documents allegedly missing from PwC's previous production and demanding that PwC comply with the court's order.

On July 29, 2002 PwC wrote:

Enclosed are the detailed tables of contents for:

1. The 1995 Coopers & Lybrand Financial Accounting and Reporting Manual;
2. The 1996 Coopers & Lybrand Assurance Services Manual;
3. Coopers & Lybrand policy updates through August 6, 1999;
4. R & Q Alerts through August 6, 1999;
5. The 1999 PricewaterhouseCoopers Accounting and Reporting Manuals, Volumes 1 and 2;
6. The 1996 Coopers & Lybrand SEC Handbook;
7. The 1997 Coopers & Lybrand SEC Handbook;
8. The 1999 PricewaterhouseCoopers SEC Manual;
9. The Coopers & Lybrand SEC Manual, Sixth Edition; and
10. The PricewaterhouseCoopers Audit Databases as of July, 1998 and November, 1999 (which may include items beyond the reporting date of August 6, 1999).

Also included are the following professional literature references:

1. ASM 160;
2. ASM 4650.32;
3. FARM Section 70, paragraph 38; and
4. AAR 1170.34

Letter from Elliott to Steven J. Miller ("Miller"), Carson, and Bell, July 29, 2002; Pinney app. 2; Exh. 20.

On August 8, 2002 Telxon wrote PwC the following response:

With respect to those items specifically referenced in PwC's workpapers, your production is seriously deficient. Judge Hemann ordered that all such materials referenced in the workpapers be produced. You have produced only a few such items. Frankly, we were led to believe the PwC was compiling these materials during the month it took to respond. We expect that these items can be readily compiled, and request that they immediately be made available for inspection and copying.

Letter from Maria A. Campagna ("Campagna") to Porritt and Elliott, August 8, 2002; Pinney app. 2; Exh. 21, p. 1. PwC's response was as follows:

With regard to the PwC materials referenced in the workpapers themselves, we believe the materials produced so far are complete. Based on our review of the workpapers, we are not aware of any additional portions of internal PwC or Coopers guidance that are specifically referenced in the workpapers describing the work performed. If you believe there are other references to PwC's internal guidance that have not been produced, please provide the workpaper reference and we will look into it.

Letter from Porritt to Campagna, August 9, 2002; Pinney app. 2; Exh. 22, p. 1. The letter also stated, "I think that Judge Hemann made it clear that we are entitled to know who [your] consulting expert is before we produce any PwC internal guidance to Telxon." *Id.*

Telxon continued to object to what it regarded as PwC's failure to produce all internal guidance materials referenced in PwC's workpapers. On September 19, 2002 it wrote to PwC:

With respect to [internal guidance materials specifically referenced in PwC's workpapers], Judge Hemann ordered that "to the extent there are references to . . . policies, then indeed you will produce those manuals." (Transcript of proceedings before Judge Hemann on June 26, 2002, p. 14). PwC has produced only 3-4 such materials, but has withheld other referenced materials on the basis that they are not necessary to Telxon's understanding of the workpapers. This is your position, despite the fact that you admitted that you did not actually review the workpapers before making your production. I am therefore at a loss as to how you can represent that the withheld materials need not be produced. Moreover, this contradicts your prior representation to Telxon that all materials referenced in the workpapers have been turned over. This notwithstanding, Judge Hemann ordered

that all referenced materials be produced. The conditions you seek to impose are contrary to the Court's order. At this time, Telxon agrees to table this issue until such time as it has reviewed the specific internal materials that PwC will produce on or about September 23, 2002.

Letter from Campagna to Porritt, September 19, 2002; Def. opp.; Exh. S, pp. 2-3.³

On October 15, 2002 PwC again assured the court that every document responsive to Telxon's discovery requests had been produced. Transcript of Proceedings, October 15, 2002; Pinney app. 2; Exh. 28, p. 58.

Telxon again wrote PwC on the subject of internal guidance documents on October 23, 2002:

Telxon has reviewed the limited production of practice and procedure manuals provided by PwC and finds the production inadequate. Magistrate Hemann, at the June hearing, ordered PwC to produce all portions of the C&L and PwC manuals referenced in the work papers. [Porritt] has acknowledged that PwC has not produced all referenced portions and instead only produced those which, in his sole opinion, are "relevant" to understanding the work papers. This is not acceptable and not what the court ordered. All portions of the referenced manuals--which [Porritt] has conceded would be the entire manuals--must be turned over.

Letter from Bell to Porritt, October 23, 2002; Pinney app. 2; Exh. 29, p. 1.⁴

PwC responded to Telxon's concerns regarding internal guidance documents as

³ Incredibly, PwC cites this letter as evidence for its assertion that Telxon believed PwC's production of documents to be satisfactory. See Def. opp. at 13; see *also* *infra* at pp. 56-58.

⁴ Telxon also noted PwC's apparent failure to produce requested documents from affiliates, subsidiaries, and agents; the work histories of the PwC personnel on the engagement team; a list of items on the Master Data database; and information respecting PwC's clients for which PwC had prepared restated financial statements. The letter ended, "None of the requests in this letter are burdensome and many are long overdue. We would ask for production of the documents and restatement list, and further response to the interrogatory, no later than one week from this date." *Id.* at 2.

follows:

[T]he question of further production of PwC internal guidance was discussed on a conference call with Maria Campagna and Hilary Sobel ["Sobel"; attorney for plaintiffs] on September 19, 2002. During that telephone call, PwC stated its view that it had produced the internal guidance it had identified following its review of the workpapers, where that guidance was expressly referenced in the workpapers in describing the work performed. We also discussed the fact that any other internal guidance that may be discussed in the workpapers should be included in the internal guidance for which indices were provided and from which both plaintiffs and Telxon have received the provisions they wanted. It was left that if either plaintiffs or Telxon identified some internal guidance referred to in a workpaper that had not yet been produced by PwC, then that party could request the production of that document and PwC would consider the request. See September 19 letter from Sobel to Porritt.⁵ Accordingly, we believe this issue has been resolved. If you have a specific workpaper in mind then, as per the agreement between the parties, please identify it and we will consider the request for production.

Letter from Porritt to Bell, November 4, 2002; Pinney app. 2; Exh. 30, p. 2. The letter also assured Telxon and plaintiffs that all documents on the electronic databases maintained by Coopers & Lybrand ("Coopers"), Telxon's previous auditors, and by PwC, Telxon's

⁵ The referenced letter from Sobel to Porritt stated that plaintiffs concurred with the summary of the conference set forth in the September 19, 2002 letter described above. The letter also stated,

[P]laintiffs agree, as did Telxon, to accept the production by PwC of the selected portions of the manuals identified by plaintiffs and Telxon . . . [W]hile we believe that the production of four pieces of professional literature is insufficient, in light of your belief that the selected portions of the PwC manuals will duplicate the guidance itemized in the work papers, we have agreed to table that issue for now. We have also agreed that should plaintiffs find professional literature identified in the work papers that are not encompassed in the manual portions, plaintiffs will not be precluded from requesting the production of that additional guidance.

Def. opp., Exh. T, pp. 1-2. As Sobel's letter made clear, and as had Campagna's, further discussion of the issue of production of internal guidance was conditional on Telxon's and plaintiffs' finding that the promised production of portions of the manuals selected by PwC would satisfy their concerns.

auditors after Coopers merged with Price, Waterhouse, had already been made available to Telxon and plaintiffs.

On October 23, 2002 Telxon reminded PwC that its first request for documents had asked for all relevant documents from all of PwC's databases. PwC responded on November 4, 2002, assuring Telxon that all documents on its various databases had been produced.

Telxon wrote PwC on November 15, 2002, noting that certain internal guidance appearing in the workpapers had not been provided by PwC and requesting that material.

According to Pinney:

36. In late November 2002, I reviewed PwC's workpapers and identified a particular internal guidance (ARM 9612.23) that is critical to Telxon's claims against PwC. This internal guidance addressed sales arrangements with distributors, a central issue to this case because it is Telxon's position that PwC wholly failed to understand Telxon's sales to "value-added distributors," known as "VADs." ARM 9612.23 was specifically referenced in PwC workpapers (and cross-referenced in a separate internal guidance section), but never produced by PwC until Telxon complained of its non-production. I attempted to locate ARM 9612.23 on the indexes PwC provided Telxon and Class Plaintiffs, but could not locate it. I reviewed Class Plaintiffs' correspondence dated August 30, 2002 that set forth a list of the internal guidance Class Plaintiffs wanted produced. ARM 9612.23 was not listed and had not been produced by PwC. Once again, I carefully reviewed the indexes PwC provided Telxon and Class Plaintiffs on July 29, 2002 as ordered by Magistrate Judge Hemann on June 26, 2002.

After a second careful review, I discovered that certain pages in the internal guidance index were replaced with another unrelated index. This replacement went unnoticed by Class Plaintiffs and Telxon for several months because the page numbers at the bottom of the replaced pages matched the wrong pages. See, e.g., Exhibit 32 (PWC 66475 (page "2 of 7") attached thereto).

On November 26, 2002, I sent PwC a letter requesting PwC to produce ARM 9612.23 and pointed out that certain critical index pages were not produced, but were substituted with unrelated but similar pages in certain instances. See Exhibit 32. I asked PwC to confirm that it "has produced the appropriate tables

of contents for each 'Internal Guidance' manual." After discovering this, I was concerned that the pages were intentionally switched and replaced. Up until this time, our consultants were advising me that the production was incomplete.

37. On December 18, 2002, I sent PwC a letter demanding PwC to respond to Telxon's outstanding inquiries concerning the internal guidance indexes (including an inquiry by my paralegal), as well as other outstanding discovery issues.

38. For six weeks, PwC refused to respond to Telxon's inquiry about the missing internal guidance indexes. Finally, on January 14, 2003, PwC produced several sections of internal guidance that I requested, including the correct pages of the indexes that I called into question. See, Exhibit 34. PwC attributed its mistake to a "clerical error" (without further explanation) and for the first time since Magistrate Judge Hemann's June 26, 2002 Order produced ARM 9612. See, Exhibit 34, pg. 1, ¶3. Section 23 of ARM 9612, titled "Rights of Returns," turned out to be a critical document in Telxon's case against PwC. This document was used as Exhibit 1277 during the Daniel Cola deposition. See, Exhibit 35. In addition, it is referenced in Telxon's Expert Report by Professor Ray Stevens. See, Exhibit 73, pg. 46.

In summary, Telxon first requested production of PwC's internal guidance on April 18, 2002, and Magistrate Judge Hemann ordered its production on June 26, 2002, yet PwC refused to make accurate production of internal guidance until January 14, 2003 (which, as we now know, was still an incomplete production).

Affidavit of Pinney ("Pinney aff."), Tel. mot., Exh. B, pp. 9-10. PwC offers no further explanation of the switched index pages, nor does it contest Telxon's description of ARM 9612.23 as a "critical document."

On January 24, 2003, during the deposition of Hellwarth, Telxon drew PwC's attention to missing sections of deposition exhibit 835. PwC's counsel produced a corrected version of the document on January 29, 2003, attributing the missing sections to a "printing error." According to Pinney, "The 'corrected' version of Exhibit 835 memorialized critical discussions that occurred during a meeting with Telxon's Audit Committee. The 'corrected' version demonstrates that PwC did not raise any revenue

recognition issues regarding sales to Telxon's distributors . . . during the first quarter of fiscal year 1999." Pinney aff. at 10. PwC does not respond to Telxon's assertions regarding Exhibit 835 from the Hellwarth deposition.

On February 6, 2003 Telxon and plaintiffs served a joint request on PwC for full production of its electronic databases. On February 25 and 26 Telxon sent letters to PwC asking that PwC produce additional internal guidance materials referenced in the workpapers but not provided by PwC. On March 14, 2003 PwC denied Telxon's and plaintiffs' request for the entire electronic databases. The letter observed:

The workpapers from the electronic databases, together with the external binders, have already been produced in hard copy in the same order and format as they are maintained in the electronic database. This production took place over two years ago. Nonetheless, Telxon and plaintiffs now request production of the electronic database in electronic form supposedly due to some issues regarding your purported inability to comprehend the workpapers as they have been introduced.

Letter of Porritt to Pinney and Sobel, March 14, 2003; Appendix to Pinney aff., Vol. 3 ("Pinney app. 3"; Docket #295 (5:98CV2876)); Exh. 40, p. 1. PwC maintained that it had produced these materials in full in hardcopy and in the order and format as they appeared in the databases. Moreover, in response to Pinney's complaint that produced documents contained incorrect cross-references and missing tickmarks⁶ and attachments, PwC asserted, "I am not aware of a single missing tickmark, incorrect cross reference, or electronic attachment to a workpaper that has not been printed out[,] and the examples provided in your letter also do not support your assertions." *Id.* at 2.

On March 26, 2003 PwC produced 457 pages of documents from fiscal year 1997.

⁶ "Tickmarks" are a form of pop-up.

PwC explained:

In further response to your letter of February 26, 2003 . . . we have undertaken a review of the electronic database and a comparison of our document production. As a result of that review, I am enclosing certain additional documents from the database from the fiscal year 1997 audit of Telxon. These documents were contained in the database under views entitled "review comments" and "items marked for deletion," and are referenced in the index of the electronic database that PwC produced to you. While you have not inquired about the documents in these views, we have concluded that they may not have been copied and produced as part of PwC's earlier document production in this matter.

Letter from Jeffrey L. Handwerker ("Handwerker")⁷ to Pinney and Sobel, March 26, 2003; Pinney app. 3; Exh. 41, p. 1. The letter concluded, "PwC has now provided Telxon and Class Plaintiffs with all pertinent documents that are contained on PwC's electronic database." *Id.* at 2.

Telxon and plaintiffs renewed their request for production of the electronic databases on March 28, 2003. Their letter noted, "To suggest that continued piecemeal production of documents in hard copy format, coupled with periodic explanations by witnesses when problems arise is sufficient . . . ignores PwC's discovery obligations." Letter from Sobel and Pinney to Handwerker, March 28, 2003; Pinney app. 3; Exh. 42, p. 1. Telxon and plaintiffs told PwC that "[t]he absence of complete and accurate work papers from the PwC databases" might have affected five recent depositions, and they again reminded PwC of its discovery obligations. The letter further noted that the recent production of documents consisted mostly of documents which had never before been introduced, that the recent production itself was incomplete, that the production indicated

⁷ Porritt had left Arnold & Porter, PwC's attorneys, at this point.

gaps in previous document production for other fiscal years, and that PwC's objections to providing certain documents on the grounds of relevancy were not justified. For these reasons, the letter concluded, PwC should make its electronic databases available to Telxon and plaintiffs.

On March 31, 2003 PwC produced copies of documents which included missing tickmarks and promised a future production which would include all missing attachments. PwC asserted, "We have carefully reviewed the electronic database and will represent again, as I stated in my March 26, 2003 letter, that Class Plaintiffs and Telxon now have all of the documents on the PwC database that are responsive to your document requests." Letter from Handwerker to Sobel and Pinney, March 31, 2003; Pinney app. 3; Exh. 43, p.

2. PwC's letter also asserted,

While Rule 34 does authorize and contemplate electronic discovery under certain circumstances . . . it does not permit the cumulative, burdensome, and unnecessary discovery of a confidential electronic database after all of the documents included on that database already have been produced in hardcopy format. . . . Here, paper copies of all responsive documents on PwC's database have been produced to all parties. Therefore, PwC has comported fully with its discovery obligations

Id. at 2-3. PwC also reasserted its claim that to give Telxon and plaintiffs access to the electronic databases and the software needed to access them would be to reveal trade secrets.

On April 1, 2003 PwC produced additional documents from the audit of Telxon's 1997 fiscal year.

Telxon and plaintiffs wrote to the court on April 16, 2003, detailing the problems they were having in obtaining complete, accurate, and prompt discovery from PwC. PwC

responded by a letter to the court on April 18, 2003. Citing "certain alleged 'issues' with PwC's production of its working papers," PwC told the court that "[t]he Class Plaintiffs⁸ ask the Court to believe that PwC's production of work papers in this proceeding has suffered from some major flaw that should be remedied at this late date in the discovery schedule." Letter from Elliott to J. Hemann, April 18, 2003; Pinney app. 3; Exh. 45, p. 1. PwC termed plaintiffs' request "an unfounded attempt to impose unnecessary and cumulative discovery burdens on PwC and to require PwC to reveal confidential trade secrets" *Id.* The letter described the problems cited by Telxon and class plaintiffs as "insignificant" and assured the court that the parties had not been prejudiced by any errors in the production of PwC's documents. The letter also declared, "PwC has produced its substantial documentation to all parties in this case in hard-copy format, and already has complied fully with its discovery obligations." *Id.* at 3. PwC reminded the court of its contention that to give Telxon and plaintiffs access to the electronic databases and the software needed to access them would be to reveal trade secrets. PwC concluded by stating, "Only now, at the very close of the fact discovery period, have Class Plaintiffs chosen to press this issue with the Court and insist that they need possession of the database itself. In light of the prejudice to PwC that production of the database would entail, the Court should not permit Class Plaintiffs or their experts . . . to have access to this proprietary software and supporting materials." *Id.* at 4.

⁸ Telxon withdrew its request for the electronic databases on April 18, 2003, reserving its right to receive a copy of the databases should the Court order their production.

On April 29, 2003 PwC produced documents which Telxon had determined on April 8, 2003 were missing from PwC's previous document productions. On that same day the court held a hearing by telephone on the question of whether PwC should be required to produce its electronic databases for Telxon and plaintiffs. When Pinney asked Handwerker at the hearing whether the documents produced that day had previously been produced, Handwerker said, "Frankly, they may well be in our production already, but I received a call from Mr. Pinney on Friday asking for these documents again, so out of an abundance of caution we produced them again."⁹ Transcript of Proceedings, April 29, 2003; Pinney app. 3; Exh: 46, p. 5.

During the hearing, counsel for plaintiffs described the shortcomings of PwC's hardcopy production of PwC's electronic documents, including a failure to reproduce color-coded commentary and attachments. In responding to this description, Handwerker noted that because PwC's electronic databases contained trade secrets, they were not discoverable. Handwerker told the court that "the plaintiffs have not identified, to my knowledge, a single work paper or a single important or operative document that they would expect to see in our [electronic] production that isn't there. That's not the issue in this case, I don't believe." *Id.* at 11. PwC also contended that plaintiffs had asked that PwC produce documents in the same manner in which they had been provided to the SEC and that PwC had complied with that request. In ruling against production of the electronic databases the court noted that PwC had represented that the design of the database was

⁹ Pinney asserts, and PwC does not now deny, that these documents had not been produced. See Pinney aff. at 12.

a trade secret. The court concluded,

Nor does there appear to be any dispute that defendant has produced documents in chronological order by audit year and has produced indexes of the documents produced. To the extent that PwC has produced some documents late due to mistake or produced documents a second time out of an abundance of caution, neither of those scenarios justifies requiring it to produce, at this late date, its proprietary software.

Order, May 5, 2003 (Docket #175 (5:98CV2876)), pp. 3-4.

Plaintiffs appealed the magistrate judge's order to Judge O'Malley. In PwC's memorandum in opposition, PwC asserted:

Class Plaintiffs try to create a basis for their position solely by repeating a number of inaccurate allegations that they also tried with the Magistrate about the quality of PwC's hard-copy document production. Those allegations, which consist mostly of unfounded assertions about PwC's veracity, are without substance and should be discredited. **PwC's hard-copy production is complete and entirely adequate.** PwC has produced more than 55,000 documents in this matter, along with indexes for the documents from the electronic database. The documents from the database are organized by audit year. Within each audit year, PwC has produced the workpapers by audit area, and attachments to the workpapers were inserted into the production behind the workpapers to which the attachments relate. While Class Plaintiffs identified a handful of printing errors or other glitches relating to a few documents during the course of discovery, PwC promptly remedied those errors without any prejudice to the Class Plaintiffs--as the Magistrate correctly found. Those few production issues out of tens of thousands of pages of documents, issues that were quickly resolved, simply do not provide the necessary basis to order the production of PwC's proprietary database.

Memorandum in Opposition to Plaintiffs' Objections to May 5, 2003 Order (Docket #182 (5:98CV2876)), p. 4 (emphasis added). The court upheld the magistrate judge's order.

Additional developments in 2003 indicated that PwC's production of documents in fact had been incomplete. According to Pinney:

52. On July 9, 2003, I took the deposition of Tammy Hulshof ["Hulshof"] (nee Overmier), a PwC staff auditor. During the course of the deposition, Mrs. Hulshof testified in response to my questions that she maintained what she referred

to as a "CYA file" or "cover your audit file" (aka "desk file"). Mrs. Hulshof testified that she put in her CYA file "[a]nything that is not put into the work papers, any backup that I have, any documentation from inquiries." Prior to taking Ms. Hulshof's deposition, I conducted a review of the documents produced by PwC. PwC had never produced Mrs. Hulshof's CYA file. As noted above, PwC previously represented to Telxon that it produced all desk files maintained by members of the engagement team (See Paragraph 20 of this Affidavit.) Mrs. Hulshof testified that she provided Dan Cola her CYA file prior to her departure in May 2000. Following Mrs. Hulshof's deposition, I served a Request for the Production of Documents calling for the production of Mrs. Hulshof's CYA file or desk file, as well as any similar files maintained by the engagement team. See, Telxon Motion for Leave to File an Amended Complaint to add a count for spoliation of evidence, docket number 253 (Mrs. Hulshof's testimony and Telxon's Request for the Production of Documents are contained in Telxon's Appendix filed herewith.) Before PwC's response date, the case went into mediation and discovery was stayed.

Pinney aff. at 13; see *also* Deposition of Tammy Hulshof ("Hulshoff") ("Hulshoff depo.," Docket ##321 (5:98CV2876), 177 (01:CV1078)), pp 54-60.

On December 19, 2003 the court entered an order preliminarily approving a settlement reached between Telxon and plaintiffs for \$37 million. Fact discovery in the case closed on that date.

On February 3, 2004 the parties held a conference call to discuss various matters at issue in the litigation. Telxon pointed out that a number of documents remained missing from PwC's production and that other documents had apparently been altered since PwC had been put on notice to preserve them. Plaintiffs were particularly concerned about a document referenced in PwC's recent interrogatory responses, a document which was part of the fiscal year 1998 review but which PwC auditor Andrew Ennis ("Ennis") marked as reviewed in January 1999, well after the 1998 fiscal year review had concluded. PwC promised that it would look into the matter.

Following mediation, PwC responded as follows to the request for Hulshof's CYA

file:

Objection to Request No. 1:

Subject to and without waiver of its General Objections set forth above, PwC objects that this Request is vague, ambiguous, overly broad and duplicative of previous Requests.

Response to Request No. 1:

Subject to and without waiver of its General Objections set forth above, PwC responds that, following Ms. Hulshof's deposition, it conducted a further review of its files for any Tammy Hulshof (nee Overmier) files and documents that had not previously been produced in this matter. Based upon this review, PwC states that it does not have any documents within its possession, custody or control that are responsive to this request.

Third-Party Defendant PricewaterhouseCoopers LLP's Response to Third-Party Plaintiff Telxon Corporation's Request for Production of Documents; Pinney app. 3, Exh. 51, p. 6. Despite having previously asserted that PwC had produced the personal desk files of the PwC auditors, see June 24, 2002 letter at 1, PwC wrote to plaintiffs:

Your letter also requests that PwC advise Class Plaintiffs of the circumstances of the "disappearance" of Tammy Hulshof's file. This inquiry assumes, of course, that this file existed, and that if it did exist it should have been retained. Neither GAAS nor PwC's audit documentation policies require that back-up materials relating to information included in work papers be retained. Indeed, once the workpaper is completed, it is not necessary under GAAS or PwC's procedures to retain a separate piece of paper that contains the same information.

Letter from Handwerker to Sobel, February 23, 2004 ("Feb. 23, 2004 letter"); Pinney app. 3; Exh 52, p. 7.

The Feb. 23, 2004 letter also responded to some of the shortcomings plaintiffs had found in PwC's document production. Accompanying the letter was yet another document, a workpaper with reference number 9000-1. This had been one of the missing documents requested by Telxon on February 3, 2004. PwC's letter characterized the document and accompanying attachments produced on February 23, 2004 as "substantively identical to

the previously produced documents labeled PwC 0017407-11." *Id.* at 6.

On February 24, 2004 plaintiffs prepared a supplemental submission in support of their objections to the magistrate judge's May 5, 2003 order. Plaintiffs argued that PwC's document production had been so unsatisfactory as to raise serious doubt that plaintiffs could have any assurance that they had access to all relevant documents without production of PwC's complete electronic databases. The supplement complained specifically about the recent production of the workpaper with reference number 9000-1. Objecting vigorously to PwC's contention that the document was "substantively identical to the previously produced documents labeled PwC 0017407-11," *id.* at 6, plaintiffs contended:

PwC seeks to justify its failure to produce this workpaper, despite its continued representations to the Court that *all* work papers have been *previously produced* by claiming that the omitted documents "are substantively identical to the previously produced documents labeled PwC 0017407-11." That explanation does not address the fact that PwC *never* produced *this* document. Moreover, PwC's attempted justification of its belated production belies the fact that the originally produced document apparently was created contemporaneously with the 1998 audit engagement, while the newly produced document purports to relate to the 1998 audit engagement but was created well after the fact, on January 28, 1999--after the commencement of these actions and well after the conclusion of the 1998 audit on June 26, 1998.

Supplemental Submission in Support of Class Plaintiffs' Objections to the May 5, 2003 Order of Magistrate Judge Hemann Regarding Plaintiffs' Motion to Compel Production of PwC's Electronic Workpaper Databases, Pinney app. 3; Exh. 53, p. 2 n.1.

On March 1, 2004 PwC responded to the supplemental submission with a letter which included the following:

As you know, the document to which Class Plaintiffs' Supplement relates is

substantively identical to a document that PwC previously produced in this litigation. **However, although PwC continues to believe that your Motion to Compel lacks merit, PwC is willing, in the interests of putting an end to this needlessly time-consuming sideshow as this case moves toward summary judgment, to produce its workpaper databases for FY 1997 to FY 1999 in the hope of ending this already over-prolonged "controversy," in which form has been exalted over substance.** We are prepared to begin those discussions with you promptly.¹⁰

I will contact you shortly to discuss the terms of a protective order and to work out the details of this production. In the meantime, we will advise the Court that your appeal of Magistrate Judge Hemann's Order is now moot.

Letter from Handwerker to Richard A. Speirs ("Speirs"), March 1, 2004; Pinney app. 3; Exh.

54. The parties began discussions as to the terms of PwC's desired protective order.

On April 9, 2004 PwC submitted to Telxon and plaintiffs a Stipulation of Authenticity of Certain Documents for Use in Connection with Motions filed Pursuant to Federal Rule of Civil Procedure 56 ("Stipulation"), Pinney app. 3, Exh 55. PwC sought a joint stipulation from all parties that the documents the parties had produced during the litigation "shall be deemed 'authentic' for purposes of any motions for summary judgment, opposition to motions for summary judgment, and replies to oppositions to motions for summary judgment filed in the above actions pursuant to Rule 56 of the Federal Rules of Civil Procedure." Stipulation at 1. Telxon and plaintiffs refused to sign the Stipulation.

PwC filed its motion for summary judgment against Telxon and plaintiffs on April 12, 2004, and on April 13, 2004 Telxon and plaintiffs executed a protective order with regard to PwC's databases. Expert discovery in the case closed on April 20, 2004.

¹⁰ The arrogance demonstrated by PwC in the face of plaintiffs' serious allegations and PwC's obvious failings is beyond anything this court has seen in 11½ years on the bench.

On April 21, 2004 Telxon and plaintiffs received from PwC five CDs containing PwC's electronic workpaper databases for PwC's audits and reviews of Telxon's fiscal years 1997-1999 year end and interim financial statements¹¹ and a banker's box containing nearly 3,000 pages of documents. The accompanying letter told Telxon and plaintiffs that the CDs could be read using an off-the-shelf software, Lotus Suites. The letter also contained the following explanation for the production of the electronic databases:

PwC's Review of its Databases: As you know, PwC responded to a series of subpoenas from the Securities and Exchange Commission ("SEC") relating to Telxon between February and August 1999, and made a number of follow-up productions to the SEC over the course of the SEC investigation. PwC produced at that time what it believed to be a complete set of its Telxon-related working papers in hard copy. Subsequently, PwC and Class Plaintiffs agreed that PwC could replicate its SEC production in this case, and the SEC production was used as the basis for the document production in this case.

In its December 19, 2003 interrogatory responses, PwC identified a document from its FY 1998 archived workpaper database that Andrew Ennis marked as reviewed in January 1999. During our "meet and confer" conference call in February 2004, Class Plaintiffs' counsel asked PwC to specify the bates number of that document, because Class Plaintiffs had not been able to locate the exact document in PwC's document production. PwC promptly reviewed its document production and learned that the particular document identified in PwC's interrogatory answer had not been produced. Instead, PwC apparently produced a document containing the same information that was maintained in a different area of the electronic workpaper database. PwC volunteered this information to the Class Plaintiffs and to Telxon (see letter of February 23, 2004), and produced the additional document to all parties.

Subsequent to this discovery, PwC investigated its electronic databases to determine the reasons for the difference. During the course of this investigation, PwC for the first time learned the following information:

- The production to the SEC of the FY 1997 workpapers appears to

¹¹ The fiscal year 1996 financial statements were prepared before PwC's use of electronic databases, so those statements exist in paper form only.

have been made from the version of the FY 1997 database maintained on the PwC servers, which had been "archived." A "local" version of this database also existed on a laptop computer and had not been copied.

- The production to the SEC of the FY 1998 workpapers appears to have been made from the "local" version of the FY 1998 database. An electronic version of this database also existed on the PwC server (an "archived" version) and had not been copied.
- The production to the SEC of the FY 1999 workpapers appears to have been made from the "server" version of the FY 1999 database. (By agreement with the SEC, the FY 1999 workpaper database was preserved, but not "archived," because the SEC investigation was pending while the audit of Telxon's FY 1999 financial statements was taking place.)¹²

PwC is producing today copies of both the "archived" database and the "local" database for the FY 1997 and 1998 audits and reviews. PwC is also producing today the "server" version of the database for FY 1999. In addition, to save time for the Class Plaintiffs and Telxon and to facilitate your review, PwC is also producing today hard copies of certain documentation as noted below.

PwC was able to determine the existence of certain differences between versions of documents by comparing the documents that it produced in hard copy discovery with the electronic versions of the documents on the archived and local databases. Upon learning that there were some apparent differences between the hard copy production and the electronic databases for FY 1997 and 1998, PwC compared all of the documents on the databases with the hard copy production. As a result of this comparison, we have learned the following:

- For FY 1997, because the local version that was not copied is an earlier version of the database than the archived version, there are a number of documents on the local version that contain "reviewed by" and "completed by" dates that are different from the dates as they appear on the archived version of the same documents (see PWC 7200-143), or that do not appear in the archived database (see PWC

¹² The workpapers produced for the fiscal year 1999 audit of Telxon were never archived. When a database is put into the archive, it becomes a "read only" document. Until that time, the database may be modified by users.

73151-59), or that contain different text than the document in the archived database (see PWC 73175-253). In addition, there are a number of FY 1997 "audit program steps" that do not appear to have been produced in PwC's hard copy production. See PWC 7200-72410 (from local version) and PWC 72411-817 (from archived version). However, the substance of these audit steps is reflected in the FY 1997 workpapers that were produced. These audit steps are also reflected on the index of documents previously produced to Class Plaintiffs and Telxon at Bates No. PWC 45032-45060 and previously marked as Deposition Exhibit 7. Grant Hellwarth testified about this specific index at his Rule 30(b)(6) deposition in May 2002. Hellwarth Dep. Tr. at 171:1-177:17.

- For FY 1998, we have identified only a few differences between the local version (from which the hard copy production apparently occurred) and the archived version: (a) the document identified in our supplemental interrogatory response, which PwC produced to the parties, was mislabeled as a 9200-1 document in the local version but properly labeled as a 9000-1 document in the archived version; (b) working paper reference 200-2, as well as reference 200-3 (linking to an electronic copy of the "letter of arrangement" with Telxon) were not included in the local version of the database (see PWC 72275-83); and (c) the "date modified" information on workpaper 200 ("review of effectiveness of prior year's engagement") in the local (and production) version has a different "modification" date than the archived version. See PWC 73325-27.
- For FY 1999, we have found two general differences: (a) some of the documents on the server version of the database contain a "datemark" field (see PWC 69000-70102) that does not appear on the hard copy print outs that were produced in this case; and (b) certain of the documents (see PWC 73350-497) have cut outs from PwC internal guidance materials. It does not appear that these datemark and guidance fields were printed in connection with the production of the FY 1999 workpapers, but we note the PwC did make an index of its internal guidance materials available to the parties during the Summer of 2002, the parties selected the portions of the guidance materials that they wanted to copy, and the specific guidance requested has been produced. In addition to these general differences, there are also a few instances where the document in the production has different information than the document on the server version of the database. See PWC 73525-28.

With respect to each of the databases, our review also has revealed additional printing errors for certain documents (see PWC 73550-658) that are apparent from the face of the hard copy documents that were produced and which have not been identified to date. In addition, we have uncovered certain instances where pop-up screens might not have been produced, as well as a few documents that were apparently not printed from the '98 or '99 databases (see PWC 73675-709). . . .

While PwC and we obviously regret those production issues, production of documents in this case was always conducted in good faith and the parties have not suffered any prejudice by their discovery at this time. PwC's counsel remains available to address any issues relating to the above with you.

Letter from Handwerker to Speirs and William P. Thornton, April 20, 2004 ("April 20, 2004 letter"); Pinney app. 3; Exh. 57, pp. 2-5 (footnote omitted). Telxon alleges, and PwC does not deny, that the origination data on the CDs shows that they were created as early as March 5, 2004, over a month before they were produced.

On April 26, 2004 Telxon and plaintiffs moved jointly to stay briefing on PwC's motion for summary judgment, and the court granted that motion on April 29, 2004 in anticipation of a motion for sanctions. Plaintiffs moved for sanctions against PwC on May 10, 2004, and Telxon moved for sanctions against PwC on May 11, 2004. The exhibits attached to these motions for sanctions reveal the following.

PwC stored data on two main databases: a central archive server ("archive") and various local servers. In addition, persons working on an audit might download portions of a database onto the hard drive of their laptop computers. Proper procedure called for periodically uploading work done on a database from a laptop to the local server to the archive, thus ensuring that all work was saved eventually to the archive. That was not always done, however. For this reason, differing versions of a database might be found

in a laptop, the local server, and the archive.

The electronic database for each fiscal year used IBM Lotus Notes as the primary processing program, with links embedded in Lotus Notes documents providing access to certain functions and documents in Microsoft Word, Excel, and Powerpoint programs.¹³ The core files in the database are arranged in directories, sub-directories, and folders in outline form. The program allows users to link documents, and the program tags each document with data about the document's history. These "metadata" include the author of the document, the dates and authors of modifications of the document, when and by whom a document was reviewed, and when the document was last accessed. A hard copy of a document might give one person as the last individual to modify a document and the date of that modification while the metadata attached to the document might give an entirely different person and date for a later modification because the later modifier did not record the later modification on the document itself.¹⁴ Each document is also assigned a numerical code which, *inter alia*, encodes what type of document it is (e.g., "control," "assets," "liabilities and capital," etc.). Tabs above each document tell the user the fiscal year of the data, whether the server copy or the archive copy of the data is being used, and

¹³ See Affidavit of Sobel in Further Support of Class Plaintiffs' Motion for Sanctions against PricewaterhouseCoopers LLP ("Sobel aff.," Docket #175 (1:01CV1078)), pp. 8-31 for a more detailed explanation of the organization of the electronic databases, including screen shots of file trees, documents with embedded or associated links, and metadata displays for documents in the databases.

¹⁴ PwC contends that there are other reasons for this as well. See *infra* at note 18. These "reasons" do not explain, however, why a modification not recorded on the document itself would have a date *later* than the last date of modification on the document.

the directory and subdirectory in which the document appears. These data described above are not part of a document, and they do not appear when a hard copy of a document is produced.

Icons and shaded areas embedded in each document provide links to other documents. These links may take the user to documents in the database, background papers, or internal guidance materials. These documents may have been created by the Lotus program or by Word, Excel, or Powerpoint. If they were created by one of the latter three programs, Lotus launches an application of that program to permit a reader to view the document.

Links are also embedded in documents as "pop-ups." These links are indicated by a colored box or by colored text.¹⁵ When the text in the green box is clicked, a larger box of text appears to overlay the primary document and to provide information useful to the auditor. The green box indicating a pop-up does not appear in the hard copy of a document.

Telxon and plaintiffs assert that when they examined the electronic databases provided on April 21, 2004, they found the following:

1. some documents which had never been produced in hard copy during discovery appeared on the electronic databases, including some documents not noted in PwC's April 20, 2004 letter as previously unproduced (Pinney aff. at 15-21; Sobel aff. at 35-60);

¹⁵ Because PwC produced black and white hardcopies of workpapers, the colors indicating a pop-up were often difficult or impossible to detect.

2. some documents have been produced in hard copy in a version different than the version in which it exists in the electronic databases so far produced (Sobel aff. at 68-80; Reply aff. at 4-5);¹⁶
3. some documents had been modified more frequently than was noted on the hard copy of the document, including modifications after the last modification date recorded on the document (Sobel aff. at 19-29);
4. some documents had been modified by a person not identified as a modifier on the hard copy of the document (Sobel aff. at 20-29);¹⁷

¹⁶ PwC contends that the existence of versions of documents which do not appear on the electronic databases does not necessarily indicate that PwC has failed to produce yet another electronic database. PwC cites the following example of how this might occur innocently:

[T]wo documents that PwC produced in hard copy in early 2001 are different from both of the versions of those documents on the local and server versions of the workpapers. See Sobel Aff. at ¶¶ 77-80. However, the documents that Class Plaintiffs have identified from PwC's hard-copy production (PWC 032265-68 and PWC 0005122-23) both come from PwC's external workpaper binders (a compendium of hardcopy documents relating to the audit), not from the section of the document production that contains the printouts of the electronic workpaper databases. Versions of these documents that match up to the electronic databases with its original document production. [sic] See PWC 0016704 and PWC 0014058-59 (attached as Exhibit D), That earlier versions of these workpapers were printed and maintained in hard copy files during the course of PwC's audit does not prove the existence of a third workpaper database.

PricewaterhouseCoopers LLP's sur-reply in opposition to class plaintiffs' and Telxon Corporation's motions for sanctions ("Surreply"; Docket #183), pp. 15-16 (footnote omitted).

¹⁷ As PwC points out, however, the appearance of an individual's name in the metadata as having modified a document may be misleading. In some cases, that individual may have prepared a document which served as a template for the document in question. See Surreply at 12-13. In other cases, the appearance of an individual's name in the metadata as having "modified" a document may indicate that the individual

5. at least one document had been modified well after the close of the 1998 audit which produced the document and just before accounting firm Deloitte & Touche ("D&T") reviewed the PwC documents as part of its due diligence for a proposed merger between Telxon and Symbol Technologies, Inc. ("Symbol") (Sobel aff. at 21-25);¹⁸

worked on the document in a previous year and the document was "rolled forward" into the next audit year, carrying the individual's name in the metadata into the new audit. *Id.* at 13 The fact remains that plaintiffs and Telxon cannot know why the name appears.

¹⁸ On November 30, 1998 D&T told PwC that it had questions about the financial statements of one of PwC's clients, Telxon. D&T was then conducting due diligence on behalf of Symbol in exploration of the possibility of a merger between Symbol and Telxon.

PwC argues in its surreply that although the 1998 audit workpapers were not archived until January 29, 1999, PwC placed those workpapers in "read only" format in November 1998 "so that Deloitte & Touche could review them in conjunction with their due diligence procedures on behalf of Symbol Technologies." Surreply at 7. PwC cites for this proposition the Deposition of Cola ("Cola dep."). But this is not what the deposition says. The relevant portion of the deposition reads as follows:

Q. What was your role in connection with the due diligence requests made by Symbol and Tel--Symbol and Deloitte & Touche?

A. I mean, as I recall, we were made aware that there was to be that due diligence and in order to provide work paper access, there needs to be an exchange of letters authorizing, you know, the company authorizing our work papers for that purpose, and various letter between us and, us, PwC, and Telxon, as well as PwC and Deloitte & Touche who were performing that review of the work papers.

Q. Was that the extent of your involvement in connection with the due diligence requests made by Symbol and Deloitte & Touche to PwC?

A. I believe also it would have been to instruct others to pull work papers, meaning get them out of the file room to have available for this due diligence, and I think that included both hard copy work papers as well as electronic work papers.

Q. How did you make available the electronic work papers without there being a fear of the work papers being modified?

6. some documents had been altered well after the close of the 1998 audit which produced them and after PwC should have been on notice to preserve those documents, including after the documents had been produced to the SEC;
7. certain metadata for the 1998 and 1999 documents were apparently missing completely (Sobel aff. at 29-31);¹⁹

A. I don't recall the entire process. I know that we made available to them what I would call a dummy computer, which I think prevented anyone from being able to edit any of the information.

Q. Kind of like the one we have here for your availability during the deposition?

A. I believe that is consistent.

Cola depo. at 299-300. Cola says nothing about putting the local server version of the database in "read only" format. Although what he is saying is somewhat unclear, he seems to be indicating either that (1) D&T was given access to the data on a computer that was not able to modify the data it displayed or (2) D&T was given the data on a portable computer with its own local version of the data on its hard drive, so that any modification of the data would be independent of the database on the local server. In any case, Cola says nothing about placing the version of the database on the local server in "read only" format, *contra* PwC's assertion.

PwC also argues that Ennis did not modify the content of the document he accessed on November 24, 1998. It asserts instead that Ennis merely moved the document from one part of the database to another. Surreply at 5. PwC provides no support for this assertion.

¹⁹ PwC responds that the metadata are not missing:

Ms. Sobel . . . references certain documents for which she asserts the metadata was [sic] missing because "the fields (on the left side of the 'Document' box in Screen Shot 30-1, for example) were missing. Sobel Aff. at ¶ 32. She asserts that the metadata "may have been deleted or simply not included" in these databases, concluding that "the absence of this information is yet another reason to call into question the completeness of PwC's production." *Id.* The metadata for

8. local server and archive versions of the 1997 and 1998 audit papers exist, and those versions differ in some respects;
9. the 1999 audit database exists in local but not archived form;
10. PwC produced documents relating to the same fiscal year from both local server and archive databases as early as April 2003 (Sobel aff. at 32-34);
11. some text accessed via pop-ups on the electronic versions of documents were never made available to Telxon and plaintiffs on the hard copies of those documents produced during discovery (Sobel aff. at 35-52);
12. some icons, shading, boxes, and colored text indicating pop-ups were absent from PwC's hardcopy production (Sobel aff. at 56-60);
13. some of the unproduced text accessed via links and pop-ups included internal guidance materials (Pinney aff. at 16-19);
14. documents were produced in hard copy in discovery in an order different from the order in which they appear in the electronic databases (Sobel aff. at 82-93; Reply aff. at 20-23) ;
15. documents were indexed in multiple ways (by type/status, by status/type, by

the documents cited by Ms. Sobel (and the other documents in the databases) is [sic] not missing, nor has it been deleted. Had Ms. Sobel clicked on the "Document Info." tab under the Document Properties, the tab would not be blank. Ms. Sobel's "screen shots" show the "Fields" tab under the Document Properties. For documents such as those in Screen Shots 32-1 and 32-2 (Sobel Aff. at pp. 30-31) for which no "Fields" have been defined, the "Fields" tab under the Document Properties data will be blank.

Surreply at 14 n.15.

type/area, by area/type, by client site/type, by preparer/area, by origination date/area, by related area, and by modified date), and not all of these indices were produced during discovery (Pinney aff. at 22),²⁰

16. certain folders in each fiscal year database are empty, including "inbox," "outbox," and "coaching notes" folders (Pinney aff. at 23);
17. it is possible to alter any document in the database, and if the date on the computer used to alter the document is reset, the incorrect date will be incorporated in the metadata fields as the date of modification (Pinney aff. at 23);
18. pop-ups from the version of the 1998 workpapers originally produced in hardcopy form have not yet been produced (Sobel aff. at 51-52);
19. documents linked to workpapers are missing (Sobel af. at 52-56);
20. no electronic versions of internal audit workpapers have been produced (Sobel aff. at 61-63);

²⁰ PwC responds that the indices are merely re-groupings of documents it provided and that merely because it provided one index to the workpapers as an "aid" to Telxon and plaintiffs did not obligate it to produce all indices by which the documents could be grouped. Surreply at 7-8. PwC also notes:

Telxon claims that one of the "views" reveals "when a certain workpaper was modified and by whom," Telxon Reply at 14, but fails to mention that the parties have had information about when documents were modified and by whom on the hard-copy production documents since 2001.

Surreply at 8 n.10. As PwC "fails to mention" that not all modifications listed in the metadata are found on the hard copies which it produced, PwC's observation fails to reassure.

21. only one e-mail has been provided as authored by any of five staff auditors who participated in the 1997, 1998, and 1999 audits and reviews even though PwC should have been on notice to preserve such items by December 1998 (Reply aff. at 24);
22. no desk files (aka "CYA files") were produced from any of five staff auditors who participated in the 1997, 1998, and 1999 audits and reviews even though PwC should have been on notice to preserve such items by December 1998 and even though one staff auditor, Hulshof, testified that she provided her desk files to her superior, Cola, before leaving PwC in May 2000²¹ (Reply aff. at 24-25); and

²¹ When plaintiffs inquired about the disappearance of Hulshof's CYA file, PwC wrote the following:

You have requested that PwC provide additional information beyond that included in our responses to Class Plaintiffs' June 16, 2003 document requests concerning what you refer to as Tammy Hulshof's "CYA" file. In its December 19, 2003 response, PwC noted that "following Ms. Hulshof's deposition, it conducted a further review of its files for any Tammy Hulshoff (nee Overmeier) files and documents that had not previously been produced in this matter." PwC's review included inquiries of Dan Cola and all other PwC personnel involved in the initial document production. PwC also searched areas within its Cleveland and New York offices where documents of this sort might be located and made inquiries of office personnel as to where such documents might be found. Based on that review, we have confirmed that: (1) all files provided in response to document sweep letters were produced; (2) no documents provided in response to document sweep letters were discarded; and (3) PwC (as well as Mr. Cola) does not have within its possession, custody or control any documents that are responsive to Class Plaintiffs' June 16, 2003 document requests that have not already been produced.

Your letter also requests that PwC advise Class Plaintiffs of the circumstances of the "disappearance" of Tammy Hulshof's desk file. This inquiry assumes, of course, that this file existed, and that if it did exist it should have been

23. PwC continued to destroy relevant documents as part of the archiving process after it had been told by counsel to retain Telxon-related documents (Plaintiffs' Reply Memorandum ("Pl. reply"; Docket #176 (1:01CV1078)), p. 7 (citing Deposition of Hellwarth (Notice of filing under seal, Docket # 143 (1:01CV1078)), pp. 84-100)).

Examination of the hard copy production accompanying the April 20, 2004 letter also revealed problems with PwC's production during discovery. Pinney alleges that examination of the hard copy production revealed the following:

- 963 pages of new workpapers from the fiscal year 1997 audit that were never previously produced to the SEC, Telxon, or Class Plaintiffs. Specifically, this includes 400 pages from PwC's 1997 archived database (PWC 72411-72817), 410 pages from PwC's 1997 local database (PWC 72000-72410), 143 pages with dates that are different than the local and archived versions (PWC 7300[sic]-73143).
- 1102 "datemarked"²² pages of workpapers from the fiscal year 1999

retained. Neither GAAS nor PwC's audit documentation policies require that Back-up materials relating to information included in work papers be retained. Indeed, once the workpaper is completed, it is not necessary under GAAS or PwC's procedures to retain a separate piece of paper that contains the same information.

In part for this reason, we view this issue as an effort to distract the Court from the fundamental legal infirmities of Class Plaintiffs' case. Class Plaintiffs have copies of workpapers from the FY 1998 audit that contain responses to inquiries received from management. Moreover, there is no evidence in the record to suggest that Tammy Hulshof's file, if it existed, contained any documentation relating to the FY 1998 audit. See Hulshof Dep. Tr. at 153. In light of this, we do not understand the significance of this matter to any issue in the case.

Feb. 23, 2004 letter at 3-4.

²² The "datemark" function of the Lotus program allows a viewer to assemble all documents or program steps which have been altered since they were datemarked and see when they were last modified. Pinney alleges that this is the first time that documents

audit that were never produced. See, PWC 69000-70102.

- 147 pages of workpapers from the 1999 archived database that contain internal guidance that PWC never produced. See, PWC 73350-73497.
- 3 pages of workpapers from the 1999 archived database that contain "different information."
- 308 pages of printing errors. See, PWC 73550-73658.
- 312 pages of pop-up screens never before previously produced. (PwC bates labeled these to correspond to the previously produced document. These pages were hand counted).
- 7 pages of workpapers from the 1998 archived database that were never produced. See, PWC 72275-83.
- 2 pages of workpapers from the 1998 audit that have different "modified by" dates. See, PWC 73325-27.

Pinney aff. at 15-16.²³

On June 7, 2004 PwC produced another 130 pages of documents not previously produced to Telxon and plaintiffs. One of the documents was a risk summary produced on March 8, 1999, two weeks after Telxon had been forced to restate its financial statements for the previous two and a half years. Entitled "Full continuance Assessment," the risk summary included the following two items:

- B64 a. Have annual or interim financial statements in the past three years either disclosed an error in prior period financial statements or been restated for the correction of an error? **YES**
- b. Was the error due to a possible intentional or deceitful manipulation? **NO**

were produced by PwC with the notation that they had been datemarked.

²³ Pinney emphasizes that this overview of the documents is necessarily preliminary, as there is a very large number of documents to examine.

Full Continuance Assessment, Reply aff., Exh. 101 at PWC 0074047.²⁴ Plaintiffs contend that an examination of the hard copies produced on June 7, 2004 shows that "PwC failed to print inquiry documents 'linked' to the 'Review Comment' documents printed. In addition, in one instance, PwC did not open all views of the document (specifically, the 'Editor History') to show all of the information contained on the document." Sobel aff. at 52 n.15.

II.

Telxon and plaintiffs seek sanctions against PwC pursuant to Federal Rules of Civil Procedure 26 and 37 ("R. 26" and "R. 37"), 28 U.S.C. § 1927 ("§ 1927"),²⁵ and the court's

²⁴ PwC claims that the information quoted here is merely cumulative of other information already in Telxon's and plaintiffs' possession. PwC refers to excerpts from the depositions of Cola and Donald Dailey ("Dailey") with the SEC in support of this proposition. See Deposition of Cola, May 10, 2000, Surreply, Exh. 1-4; and Deposition of Dailey, May 24, 2000, Surreply, Exh. 1-5. But there are differences between the documents. It appears that Cola was questioned as to whether he believed that he was lied to by Telxon on a particular matter (this assertion cannot be verified as PwC has merely excerpted his testimony). Dailey was asked the general question of whether he *knew* of any false statements or document destruction or falsification by Telxon. The response at B64 indicates that PwC believed that an intentional error due to deceit was not "*possible*."

²⁵ Section 1927 awards sanctions as follows:

Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct

Because there is no evidence before the court from which **excess** costs, expenses, and attorneys' fees might be determined and because I am recommending the harsh sanction of an entry of default judgment against PwC, I do not also consider the penalty of an award of attorney fees in addition to an entry of default judgment. I note that attorney fees are

inherent power. PwC opposes these motions.

A. *Sanctions pursuant to R. 26 and R. 37*

Federal R. Civ. P. 26(g) provides in relevant part:

(g) Signing of Disclosures, Discovery Requests, Responses, and Objections. . . .

(2) Every discovery . . . response . . . made by a party represented by an attorney shall be signed by at least one attorney of record in the attorney's individual name, whose address shall be stated. . . . The signature of the attorney or party constitutes a certification that to the best of the signer's knowledge, information, and belief, formed after a reasonable inquiry, the . . . response . . . is:

(A) consistent with these rules and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law;

(B) not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; and

(C) not unreasonable or unduly burdensome or expensive, given the needs of the case, the discovery already had in the case, the amount in controversy, and the importance of the issues at stake in the litigation. . . .

(3) If without substantial justification a certification is made in violation of the rule, the court, upon motion or upon its own initiative, shall impose upon the person who made the certification, the party on whose behalf the disclosure, request, response, or objection is made, or both, an appropriate sanction, which may include an order to pay the amount of the reasonable expenses incurred because of the violation, including a reasonable attorney's fee.

Compliance with Rule 37 includes complete and timely supplementation of disclosures and responses in accordance with Rule 26(e).

Rule 37 provides in relevant part:

awardable as damages in securities actions pursuant to 15 U.S.C.A. § 77www(a) ("§ 77www(a)"). As Telxon and plaintiffs will have to prove damages to the court, the court may consider the question of attorneys' fees as an item of damages pursuant to § 77www(a).

(b) Failure to Comply With Order. . . .

(2) Sanctions by Court in Which Action is Pending. If a party . . . fails to obey an order to provide or permit discovery, . . . the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:

(A) An order that the matters regarding which the order was made or any other designated facts shall be taken to be established for the purposes of the action in accordance with the claim of the party obtaining the order;

(B) An order refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting that party from introducing designated matters in evidence;

(C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party

(c) Failure to Disclose; False or Misleading Disclosure; Refusal to Admit.

(1) A party that without substantial justification fails to disclose information required by Rule 26(a) or 26(e)(1), or to amend a prior response to discovery as required by Rule 26(e)(2), is not, unless such failure is harmless, permitted to use as evidence at a trial, at a hearing, or on a motion any witness or information not so disclosed. In addition to or in lieu of this sanction, the court, on motion and after affording an opportunity to be heard, may impose other appropriate sanctions. In addition to requiring payment of reasonable expenses, including attorney's fees, caused by the failure, these sanctions may include any of the actions authorized under Rule 37(b)(2)(A), (B), and (C) and may include informing the jury of the failure to make the disclosure.

A court should consider four factors in deciding whether to impose sanctions pursuant to Rule 37:

(1) whether the party's failure to cooperate in discovery is due to willfulness, bad faith, or fault; (2) "whether the adversary was prejudiced by the dismissed party's failure to cooperate in discovery"; (3) "whether the dismissed party was warned that failure to cooperate could lead to dismissal"; and (4) "whether less drastic sanctions were imposed or considered before dismissal was ordered."

Harman v. CSX Transp., Inc., 110 F.3d 366-67 (6th Cir. 1997) (quoting *Regional Refuse*

Sys., Inc. v. Inland Reclamation Co., 842 F.2d 150, 153-55 (6th Cir. 1988)). The application of these factors is more or less stringent depending upon whether the fault is the party's or the attorney's:

[T]he *Regional Refuse* factors, set forth above, have been applied more stringently in cases where the plaintiff's attorney's conduct is responsible for the dismissal. With regard to the first factor, this court has stated that "dismissal of an action for an attorney's failure to comply" should only be ordered where there is "a clear record of delay or contumacious conduct." *Carter [v. City of Memphis]*, 636 F.2d 159, 161 (6th Cir. 1980) (*per curiam*) (citation omitted). Similarly, with regard to the third factor, the court has explained that where a plaintiff has not been given notice that dismissal is contemplated, "a district court should impose a penalty short of dismissal unless the derelict party has engaged in 'bad faith or contumacious conduct.'" *Harris v. Callwood*, 844 F.2d 1254, 1256 (6th Cir. 1988) (citation omitted). Finally, with regard to the fourth factor, although it is clear that the failure of the district court to impose or make explicit its consideration of lesser sanctions is not fatal, see *Bank One of Cleveland, N.A. v. Abbe*, 916 F.2d 1067, 1079 (6th Cir. 1990); *Regional Refuse*, 842 F.2d at 155, this court recently stated that, in the absence of such consideration, and "in the absence of contumacious conduct, an alternate sanction that would protect the integrity of pretrial procedures should be utilized rather than dismissal with prejudice," *Freeland v. Amigo*, 103 F.3d 1271, 1280 (6th Cir. 1997).

Harman, 110 F.3d at 367-68.

B. Sanctions pursuant to the court's inherent powers

A district court may also award sanctions pursuant to its inherent powers. The major case outlining the court's inherent powers and their exercise is *Chambers v. Nasco, Inc.*, 501 U.S. 32 (1991):

It has long been understood that "[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution," powers "which cannot be dispensed with in a Court, because they are necessary to the exercise of all others." For this reason, "Courts of justice are universally acknowledged to be vested, by their very creation, with power to impose silence, respect, and decorum, in their presence, and submission to their lawful mandates." These powers are "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases."

* * *

[I]t is firmly established that "[t]he power to punish for contempts is inherent in all courts." This power reaches both conduct before the court and that beyond the court's confines, for "[t]he underlying concern that gave rise to the contempt power was not . . . merely the disruption of court proceedings. Rather, it was disobedience to the orders of the Judiciary, regardless of whether such disobedience interfered with the conduct of trial."

* * *

Because of their very potency, inherent powers must be exercised with restraint and discretion. A primary aspect of that discretion is the ability to fashion an appropriate sanction for conduct which abuses the judicial process. . . . [O]utright dismissal of a lawsuit . . . is a particularly severe sanction, yet is within the court's discretion. Consequently, the "less severe sanction" of an assessment of attorney's fees is undoubtedly within a court's inherent power as well.

Chambers v. Nasco, Inc., 501 U.S. at 43-46 (citations and footnotes omitted). The Court in *Chambers* also advised:

when there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute nor the Rules are up to the task, the court may safely rely on its inherent power.

Id. at 50.

III.

Telxon and plaintiffs contend that their examination of the electronic databases and documents produced by PwC on or after April 20, 2004 indicates that PwC's production failures have damaged them in the following ways.

First, Telxon and plaintiffs allege that PwC's failure to produce relevant documents and failure to produce all versions of relevant documents affected the conduct of their litigation. Pinney specifically cites PWC 0072544 (an unproduced audit step from the

Trade Accounts Receivable section of the 1997 workpapers), PWC 0072756 (an unproduced audit step from the Liabilities and Capital section of the 1997 workpapers), PWC 0072807-12 (documents from the Illegal Acts by Clients section of the 1997 workpapers), PWC 0072516-45 (documents from the Notes and other Receivables and Trade Accounts Receivable sections of the 1997 workpapers), and PWC 073688 (entitled "Accuracy of Draft Board of Directors' Minutes"²⁶ from the 1999 workpapers). According to Pinney, decisions regarding whom to depose and which questions to ask in depositions were influenced by the absence of these documents. Moreover, some of these documents go to Telxon's claims against PwC, or to PwC's defenses, or to assertions made in Telxon's expert's report. See Pinney aff. at 16-21. Finally, the failure to produce all versions of relevant documents deprived Telxon and plaintiffs of the opportunity to examine how PwC's audit evolved and the timing, nature, extent, and purpose of changes in the audit. See Sobel aff. at 64-68. PwC responds that documents PWC 0072544, PWC 0072756, PWC 0072807-12, and PWC 0072516-45 are merely duplicative or cumulative of other documents which it produced earlier. Def. opp at 33-6.

Second, Telxon and plaintiffs contend that because PwC has produced hardcopy

²⁶ PwC responds that although it did not produce this document, it did produce a memo "correcting inaccurate statements in the board minutes," a memo copied to a PwC partner involved in the 1998 and 1999 audits. Def. opp. at 36. PwC also asserts that the statements which Telxon characterizes as threats are "ambiguous statements . . . that could be construed as a threat that Telxon might sue PwC." *Id.* PwC also contends that because Telxon later assured PwC that the statements recorded in these minutes were "incorrect" and assured PwC that it had no current intent of initiating litigation against PwC, the minutes are actually part of a larger picture showing that Telxon was *not* threatening to sue PwC, and thus not impairing its independence as an auditor.

documents in a version different from any version of the documents in electronic form, the conclusion is inescapable that PwC has not yet made available to Telxon and plaintiffs all of its electronic databases relevant to this action, despite PwC's numerous assurances to the contrary. See Sobel aff. at 68-80. PwC replies that two documents which appeared only in hardcopy in a certain version were earlier versions of the workpapers which were printed and maintained in hard copy files during the course of PwC's audit. Surreply at 15-16.

Third, according to Telxon and plaintiffs PwC's failure promptly to protect documents from alteration when they were on notice that the documents might be used in litigation raises, at least, issues of negligence on the part of PwC. PwC replies that "pre-litigation spoliation of evidence has no bearing on Rule 37 issues." Surreply at 6 (citing *Beil v. Lakewood Eng'g and Mfg. Co.*, 15 F.3d 546, 552 (6th Cir. 1994)).²⁷

Fourth, Telxon and plaintiffs argue that the failure to note all modifications and all persons modifying documents on the hard copies produced during discovery caused Telxon and plaintiffs to choose not to depose certain persons or not to ask certain questions of the people whom they did depose. PwC replies that the appearance in the metadata of names listed as modifiers of a document, even though that person is not listed on the document as a modifier, may merely indicate that the listed person prepared the

²⁷ PwC is correct, although as the *Beil* court notes the practice of destroying evidence prior to litigation is not regarded favorably. Moreover, should a situation where evidence has been destroyed result in litigation, the party who chose to destroy evidence would face a presumption that the evidence would have been unfavorable to its position. See *Welsh v. United States*, 844 F.2d 1239, 1245-46 (6th Cir. 1988).

template from which the document came or authored a document which was "rolled forward" into the audit year in question. Surreply at 12-13. This response does not explain those cases in which documents were apparently modified *after* the last listed modification date. See Sobel aff. at 19-29.

Fifth, Telxon and plaintiffs contend that missing documents, missing metadata, and the modification of documents long after an audit opinion had been issued, and especially the modification of documents prior to D&T's due diligence and after the production of documents to the SEC, raise issues of spoliation. PwC answers that plaintiffs' attorney failed to find supposedly missing metadata because she tried to access them incorrectly²⁸ and that some documents were routinely modified even after issuance of an audit opinion. At least one case of alleged alteration of documents is more than suspicious. On January 28, 1999, eight days after Telxon's board of directors threatened PwC with litigation, Ennis, a PwC staff auditor later deposed by Telxon, altered data in the 1998 workpaper database. The database was archived to "read only" mode the next day, and Ennis left the employ of PwC immediately afterward. PwC's explanation that Ennis merely moved the document from one part of the database to another is without evidentiary support.²⁹

The absence of e-mail and coaching notes from the 1998 and 1999 workpapers also suggests spoliation. Part of the "archiving" process is the destruction of certain documents which will not be copied into the archive. These documents include e-mails, coaching

²⁸ See *supra*, n.21.

²⁹ See *supra* n19.

notes, review comments, and drafts of workpapers. See Reply aff. at 10. The 1998 audit workpapers, as already noted, were not archived until January 29, 1999. The absence of e-mails and coaching notes from the 1998 archive suggests that these materials were destroyed on or near January 29, 1999, after PwC was on notice to preserve those materials. See Reply aff. at 10. Telxon and plaintiffs argue that the absence of such materials from the 1999 workpapers has no ready explanation, as PwC and the SEC had agreed that these materials would not be archived. Hence, there was no justification for their destruction. See Reply aff. at 18-19. PwC responds that merely because the folders are empty does not require the conclusion that those folders must have contained files which were later deleted. Surreply at 10 n.12.

Sixth, missing documents, the absence of electronic versions of internal audit workpapers, and the absence of the electronic version of the 1998 workpapers from which the hard copies were produced raises questions as to whether PwC is still withholding discoverable material from Telxon and plaintiffs. If PwC is not withholding documents, then Telxon and plaintiffs claim an incomplete factual record upon which to prosecute their claims.

Seventh, Telxon and plaintiffs contend that the production of documents from both a local server version and an archive version for the same fiscal years as early as April 2003 shows that PwC and possibly PwC's attorneys were aware of the existence of multiple databases containing Telxon documents relevant to this litigation well before the supposed "discovery" of these databases in 2004 and the production of documents after the filing of a motion for summary judgment. PwC replies, "PwC and its counsel had no

reason to know that there were any differences between the versions of the electronic workpapers on the laptop provided to counsel and the workpapers on the PwC central server.” Surreply at 4. PwC’s attorneys do not say that they questioned PwC on this obvious issue.

Eighth, Telxon and plaintiffs assert that the failure to produce documents in the order in which they were kept and the failure to produce all indices allowing the sorting of produced documents according to topic of interest slowed Telxon’s and plaintiffs’ discovery of relevant information and increased the cost of discovery. Reply aff. at 7. PwC responds that Telxon and plaintiffs never complained about the order in which the documents were produced.³⁰ Surreply at 6.

For these reasons, Telxon and plaintiffs seek default judgment and attorney fees, or such alternative relief as the court deems appropriate, against PwC.

PwC makes a series of assertions in opposition to Telxon’s and plaintiffs’ motions for sanctions. Every one of these statements is either misleading or just plain wrong.

1. *PwC produced to the SEC what it believed in good faith to be a complete set of workpapers*

PwC produced to the SEC those documents which it later provided in its initial document production to Telxon and plaintiffs. PwC contends that this included a local

³⁰ PwC errs. Telxon and plaintiffs first complained of the organization of PwC’s document production on February 6, 2003. See Letter from Pinney and Sobel to Porritt, February 6, 2003; Pinney app.; Exh 38, pp. 1-2.

server version of the 1997 workpapers,³¹ a local server version of the 1998 workpapers, and a local server version of the 1999 workpapers. To find that PwC believed that it produced a complete set of workpapers to the SEC in good faith requires the court to believe either that PwC did not know of the existence of a laptop version of the 1997 workpapers, did not know of its own archive version of the 1997 workpapers, and did not know of its own archive version of the 1998 workpapers or that although PwC knew of the existence of various versions of the 1997 and 1998 workpapers, PwC did not believe that “good faith” required it to tell Telxon and plaintiffs of these databases or to compare the databases before it produced data contained in one database but not in another.

Moreover, to find that PwC believed that it produced a complete set of workpapers to the SEC in good faith also requires the court to find that “good faith” did not require PwC to produce the documents in the order in which they were maintained, to produce all the documents in the database, to produce documents linked to the workpapers, and to produce material embedded in the electronic versions of the documents. Plaintiffs put the matter succinctly: “All PwC had to do when it initially printed the workpapers was to commence with the first folder, print the documents . . . (with associated pop-ups[,] links and embedded documents) and proceed to the next folder and repeat the process. It simply chose not to do so.” Sobel aff. at 93.

At the very least, PwC expects the court to find that a “good faith” document

³¹ As already noted, Telxon and plaintiffs dispute that the hard copies of the 1997 workpapers were taken from the local server, as those hard copies differ from the electronic local server version of the papers produced on April 21, 2004.

production is one which is grossly negligent as to whether the producer has located all databases, is one in which the producer has made no significant attempt to compare what is in those databases, or is one in which the producer fails to take minimum care to produce systematically what is in a database. The magistrate judge declines to endorse such a finding. No reasonable person could believe that PwC's production to the SEC (and subsequently to Telxon and plaintiffs) was a "good faith" production.

2. *PwC and class plaintiffs agreed in good faith that PwC could produce its SEC production in response to class plaintiffs' non-party document subpoena.*

PwC and class plaintiffs could have "agreed in good faith that PwC could produce its SEC production in response to class plaintiffs' non-party document subpoena" only if both believed that PwC's original production to the SEC was made in good faith. Class plaintiffs relied on PwC's representations. PwC had no basis for representing it had made a "good faith" production. No reasonable person could have believed that PwC's production to the SEC was made in good faith.

3. *PwC responded to class plaintiffs' and Telxon's document requests in good faith.*

Once again, PwC would have the court set an abysmally low standard for "good faith." PwC assured plaintiffs, Telxon, and this court again and again that it had produced all relevant documents, and again and again that assurance proved worthless. Accepting PwC's own admission, it did not learn any of the following until *after* December 19, 2003:

- The production to the SEC of the FY 1997 workpapers appears to have been made from the version of the FY 1997 database maintained on the PwC servers, which had been "archived." A "local" version of this database also existed on a laptop computer and had not been copied.

- The production to the SEC of the FY 1998 workpapers appears to have been made from the "local" version of the FY 1998 database. An electronic version of this database also existed on the PwC server (an "archived" version) and had not been copied.
- The production to the SEC of the FY 1999 workpapers appears to have been made from the "server" version of the FY 1999 database. (By agreement with the SEC, the FY 1999 workpaper database was preserved, but not "archived," because the SEC investigation was pending while the audit of Telxon's FY 1999 financial statements was taking place.)

April 20, 2004 letter at 2-3. Further, by PwC's own admission it was not until after December 19, 2003 that PwC began to compare "the documents that it produced in hard copy discovery with the electronic versions of the documents on the archived and local databases." April 20, 2004 letter at 3. That it took PwC until *the day fact discovery closed* to begin an investigation that it should have made at the start of discovery cannot remotely be called responding to discovery requests in "good faith."

But that is not all. PwC knew by April 2003 that it had multiple databases of documents pertaining to a single audit year; in fact, it was producing documents from those multiple databases at that time. Yet PwC failed to inform Telxon and plaintiffs of the existence of these various databases, which would have allowed those parties the opportunity to request a stay or extension of discovery to allow them the time to explore the nature and contents of the databases. Instead, PwC waited until fact discovery had closed, experts had been deposed, and it had filed its own motion for summary judgment before it revealed the existence of its multiple databases.³² To ask that the court ratify such

³² PwC also burned CDs containing all the data on its databases by **March 5, 2004**, yet it waited until it had already filed its own motion for summary judgment before producing those CDs. PwC claims that it could not produce those CDs until it had a

conduct as "good faith" is to show utter contempt for the court and for the discovery process.

Nor was PwC forthcoming or co-operative when questioned about its inadequate discovery. For example, on June 10, 2003 plaintiffs directed the following interrogatory to PwC:

INTERROGATORY NO. 3:

Identify whether at any time after November 30, 1998:

- (a) PwC modified or deleted any work papers or other documents pertaining to its Telxon engagements,
- (b) the documents modified or deleted;
- (c) the circumstances surrounding those modifications or deletions, and
- (d) the person(s) responsible for or who performed the modification or deletion of the documents. To the extent that the identity of the person(s) responsible for or who performed such closing or archiving changed over time, identify all persons, and provide their corresponding dates of responsibility or performance.

Plaintiffs' Interrogatories Directed to Defendant PricewaterhouseCoopers LLP, Def. opp., Exh. 25, p. 4. On December 19, 2003³³ PwC provided this response:

Objection to Interrogatory No. 3:

Subject to and without waiver of its General Objections set forth above, PwC objects that this Interrogatory is untimely, overly broad, vague, ambiguous, duplicative of other discovery, and is not reasonably calculated to lead to the discovery of admissible evidence. Specifically, this interrogatory asks for information related to events which occurred at dates beyond the scope of this litigation. PwC further objects that the phrases "closing or archiving" and "modified or deleted" are vague and undefined. PwC also notes that PwC made a Rule

protective order in place to guard trade secrets contained in the program and the data. As a protective order existed covering all documents containing trade secrets produced in both cases, this position is ludicrous. See Docket ##63 (5:98CV2876), 19 (1:01CV1078).

³³ Discovery had been stayed pending settlement negotiations.

30(b)(6) witness available to address all issues related to PwC's document production and that Class Plaintiffs had a full opportunity to ask any questions about PwC's documentation practices at that time, and in fact asked questions regarding the subject matter of Interrogatory No. 3. See Hellwarth Tr. at 24-25.

Response to Interrogatory No 3:

Subject to and without waiver of its General Objections and Specific Objections set forth above, PwC refers Class Plaintiffs to PwC's response to Interrogatory No. 2 above.³⁴ See Hellwarth Tr. at 24-25, 167-70. PwC is not aware of any instance when a Telxon workpaper was deleted or modified after November 30, 1998. However, PwC notes that on January 28, 1999 Andrew Ennis appended a Microsoft Excel spreadsheet to workpaper 9000-1, Confirmation Control.

Defendant Pricewaterhouse Coopers LLP's Response to Plaintiffs' Interrogatories, Def. opp., Exh. 26, pp. 11-12. When plaintiffs pointed out that this document had never been provided by PwC and asked about it, PwC responded in relevant part as follows:

We . . . view this response largely as a "make work" exercise designed by Class Plaintiffs to obtain additional insight into PwC's strategy for summary judgment. **PwC's responses to Class Plaintiffs' discovery requests were thorough, complete, and certainly comply with the governing discovery rules.** Nevertheless, PwC is interested in narrowing the contested issues where possible. Accordingly, and without waiving PwC's right to object on timeliness grounds to any motion to compel that Class Plaintiffs should choose to file, we address below the specific issues that you raised in your letter.

* * * * *

³⁴ The response to Interrogatory No. 2 described PwC's policies for retaining and not retaining documents and that it followed those policies with regard to the Telxon audits. It also described the circumstances under which documents might generally be modified after issuance of an audit opinion. The response noted, "The only record of which PwC is aware of [sic] regarding modificatins made after the date of issuance of the audit report is the indication of the date on which the workpaper was last modified that appears on most workpapers from the electronic database. . . . The dates of any such modifications are reflected on the documents produced in this matter." Defendant PricewaterhouseCoopers LLP's Response to Plaintiffs' Interrogatories ("PwC's response"), Sobel aff., Exh. 26, p. 8.

With respect to Interrogatory No. 3, the PwC workpaper with Reference No. 9000-1, entitled "confirmation control," may have inadvertently been left out of PwC's document production. We enclose it, as well as the worksheet appended thereto, as Exhibit B. We note that these documents are substantively identical to the previously produced documents labeled PWC 0017407-11. All of these documents were printed from PwC's FY 1998 electronic workpapers.

February 23, 2004 letter at 1, 3 (footnote omitted) (emphasis added). What PwC's letter fails to say, however, is that while PwC's previously-produced 1998 workpapers had come from the local server, document 9000-1 came from the archive. See April 20, 2004 letter at 2. By some miracle, PwC produced this document from a data source that it claims was then-undiscovered (despite the fact that archiving is standard PwC policy) and then fails to explain that miracle when it produces the document. PwC's responses cannot remotely be characterized as "good faith."

4. *PwC did not fail to produce any guidance material, and Telxon misstates Magistrate Judge Hemann's ruling.*

On June 26, 2002 Magistrate Judge Hemann held a hearing to resolve discovery disputes among the parties. Porritt represented PwC, and Brett S. Krantz ("Krantz") represented plaintiffs. During the hearing, counsel for plaintiffs argued in favor of requiring PwC to produce all internal guidance materials which govern the conduct of audits. Counsel for PwC argued in favor of considering the production of such materials on a case-by-case basis. The following exchange occurred early in the hearing:

THE COURT: All right.

What strikes me with this issue of the internal materials is that they are discoverable materials, but not necessarily materials that can be used at trial. And I say that because I understand the argument that PwC makes about the issue not being whether in its review, and in its carrying out its responsibility for Telxon, its responsibility not necessarily being that it followed its own internal materials, but that indeed it followed GAAP and GAAS.

So that's why it appears to me that even though the argument that PricewaterhouseCoopers says maybe our, maybe our own internal procedures exceed GAAS and GAAP, I think Telxon could just as well say yes, but maybe they don't meet GAAS and GAAP, and maybe what you did was follow your internal materials and hence not satisfy the requirements of GAAS and GAAP.

So I take the position that the materials are discoverable materials with Judge O'Malley deciding at the appropriate time whether -- what the standard is and whether those materials have any role at all in the standard, the negligence standard, when it gets to trial.

Now, that being said, I think the proposal that I saw in Mr. Krantz's letter, that you layout what materials are available and then discuss whether indeed anybody needs anything, because it sounds as though there are many materials, probably a portion of which at least would not be needed by or necessary to the case of -- the case being made either by the plaintiffs or by Telxon.

So I would suggest that what you do is set out a list of the materials that would satisfy that request and then negotiate with both Mr. Krantz and with the Telxon counsel for the discovery of the most critical ones that really are the most critical. But I want it clear, and certainly to be clear in terms of the next step, or the steps down the road, that I am not in any way suggesting that those materials are appropriate for use at trial.

Transcript of proceedings, June 26, 2002 ("June 26 tr."); Pinney app. 2; Exh. 17, pp. 5-6.

The court modified its position later in the hearing:

THE COURT: Well, certainly --

(Technical difficulty).

(Record read as follows: THE COURT: Well, certainly --)

MR. PORRITT: [Argues in favor of requiring plaintiff to identify specific references to guidance materials and allowing PwC to consider whether to produce them.]

THE COURT: What I was about to say after my certainly was, to the extent that there are references to work papers, to policies, then indeed you will produce those manuals. And in addition to that, I want you to prepare a list that would satisfy that production. I want you to give it to Telxon. I want you to give it to Mr. Krantz. And I want them to be able to look at it and the three of you negotiate and work on what should be turned over.

But what I want everybody to understand here that when we're talking about discovery, my philosophy is the same as it was when I was practicing law, and that

is discovery is what cases are all about. And people aren't allowed to go on a fishing expedition and at the same time they are certainly allowed to have material that may lead to relevant material. So to the extent that this category that we're talking about falls into information that may lead to relevant material, then I think-- then I want it turned over.

June 26 tr. at 14.

PwC asserts the following as its understanding of the court's position regarding the production of guidance materials:

At that hearing, Judge Hemann directed that PwC provide a list of internal guidance materials to opposing counsel and negotiate with counsel "for the discovery of the ones that really are the most critical." *Id.* at 6. Judge Hemann also noted that "I want it clear" that "I am not in any way suggesting that those are materials appropriate for use at trial." *Id.* at 5-6. In addition, to complete the excerpt from which Mr. Pinney selectively quotes in his Affidavit (See ¶ 22), Judge Hemann stated that "to the extent that there are references to work papers, to policies, then indeed you [PwC] will produce those manuals," but she limited her ruling in an important respect: Judge Hemann admonished that guidance manuals should be produced only to the extent that they contained "information that may lead to relevant material." *Id.* She also cautioned Class Plaintiffs and Telxon not to go on a "fishing expedition." *Id.*

Def. opp. at 11-12 (footnote omitted) (insertion in the quoting document).

Pinney, in his affidavit to the court, described the court's position on producing guidance materials as follows:

22. On June 26, 2002, during a hearing before Magistrate Judge Hemann, Magistrate Judge Hemann ordered, among other things, PwC to produce all internal guidance materials referenced in PwC's workpapers and make available a list of internal guidance to Telxon and Class Plaintiffs See, Exhibit 17, pg. 14. Specifically, Magistrate Judge Hemann stated to PwC, "[y]ou will produce those manuals." *Id.*

Pinney aff. at 7 (insertion in the original).

PwC's memorandum in opposition to the motions for sanctions described how it responded to the court's order:

Following the hearing, PwC complied with the Court's directive by providing Class Plaintiffs and Telxon with indexes of its guidance materials, and producing all of the materials that the parties selected. See Aronow Decl. at ¶ 12. The indexes that PwC provided included all guidance materials that Telxon claims it was unaware of until PwC's April 20, 2004 production. In fact, all of the PwC internal guidance referenced in the April 20, 2004 production was also referenced in PwC's fiscal year 1998 workpapers, belying any suggestion that PwC was hiding these materials (or references to these materials) from Telxon or that Telxon was prejudiced in any way by the supplemental production of the guidance fields.

Consistent with the proceedings of June 26, 2002, PwC also produced all guidance materials cited in the text of PwC workpapers *that were necessary to an understanding of the work that PwC performed in its audits of Telxon*. Both Class Plaintiffs and Telxon deemed this production to be satisfactory. See Letter from M. Campagne to N. Porritt, dated September 19, 2002 (attached as Exhibit S) and Letter from H. Sobel to N. Porritt, dated September 19, 2002 (attached as Exhibit T). Indeed, Telxon and Mr. Pinney do not deny that they obtained every piece of guidance material that was necessary to understanding the work that PwC performed. Neither Class Plaintiffs nor Telxon ever filed a motion to compel discovery of additional guidance materials.

Def. opp. at 12-13 (emphasis added).

The position set forth in the letters cited in the opposition brief directly contradicts PwC's assertion that "Class Plaintiffs and Telxon deemed [PwC's] production to be satisfactory." The letter from Telxon reads:

With respect to the [materials specifically referenced in PwC's workpapers], Judge Hemann ordered that "to the extent that there are references to . . . policies, then indeed you will produce those manuals." (Transcript of Proceedings before Judge Hemann on June 26, 2002, p. 14). PwC has produced only 3-4 such materials, but has withheld other referenced materials on the basis that they are not necessary to Telxon's understanding of the workpapers. This is your position, despite the fact that you admitted that you did not actually review the workpapers before making your production. I am therefore at a loss as to how you can represent that the withheld materials need not be produced. Moreover, this contradicts your prior representation to Telxon that all materials referenced in the workpapers have been turned over. This notwithstanding, Judge Hemann ordered that all referenced materials be produced. The conditions you seek to impose are

contrary to the Court's order.³⁵ At this time, Telxon agrees to table this issue until such time as it has reviewed the specific internal materials that PwC will produce on or about September 23, 2002.

Letter from Campagna to Porritt, September 19, 2002 ("Campagna Sept. 19 letter"), Def. opp., Exh. S, pp. 1-2. The letter from plaintiffs also expressed dissatisfaction with PwC's production of guidance materials: "[W]hile we believe that the production of four pieces of professional literature is insufficient, in light of your belief that the selected portions of the PwC manuals will duplicate the guidance itemized in the work papers, we have agreed to table the issue for now." Letter from Sobel to Porritt, September 19, 2002 ("Sobel Sept. 19, 2002 letter"), Def. opp., Exh. T, p. 2. These letters are sufficiently clear about Telxon's dissatisfaction with PwC's production of guidance materials that the court regards PwC's citation of the letters for the opposite proposition to be a deliberate attempt by PwC to mislead the court.

Pinney's affidavit describes Telxon's version of PwC's compliance with the court's order of June 26, 2002. Pinney's description is fully supported by the documentary citations:

23. After almost a month passed without PwC complying with Magistrate Judge Hemann's June 26, 2002 Order, on July 24, 2002, Telxon sent PwC a letter requesting PwC to comply with Magistrate Judge Hemann's June 26, 2002 Order to produce, among other things, all internal guidance referenced in PwC's workpapers and a list of PwC's guidance and training materials. See Exhibit 18, pg. 2.³⁶ In addition, Telxon identified a series of documents that were missing from

³⁵ This refers to a condition PwC sought to impose on the production of the workpapers, viz. that they be produced for the attorneys' eyes only.

³⁶ Letter from Campagna to Porritt, July 24, 2002; Pinney app. 2, Exh. 18. The request for guidance materials and a list of PwC's guidance and training materials is

PwC's workpapers. See, Exhibit 18, p. 2.

24. On July 26, 2002, PwC served its Response to Telxon's Second Request (PwC's "Second Response"). See, Exhibit 19.³⁷ In response to Request No. 7, that called for the production of "[a]ll documents produced to plaintiffs in response to [Class] Plaintiffs Request for the Production of Documents Directed to [PwC]", PwC stated: "PwC already produced to Telxon all documents responsive to this Request." See, Exhibit 19, pg. 9;³⁸ (Class Plaintiff's Request is attached hereto as Exhibit 16,³⁹ as Exhibit A therein).

25. On July 29, 2002, PwC produced to Telxon and Class Plaintiffs, in response to Magistrate Judge Hemann's June 26, 2002 Order, documents PwC represented to be a "detailed set" of internal guidance indexes and four sets of internal guidance referenced in PwC's workpapers. PwC only produced four pieces of internal guidance. See, Exhibit 20.⁴⁰ As a result of Magistrate Judge Hemann's June 26, 2002 Order, Telxon expected PwC to produce a complete set of indexes and all internal guidance referenced in PwC's workpapers, but PwC continued to refuse to make such a production.

26. On August 8, 2002, Telxon sent PwC another letter demanding PwC comply with Magistrate Judge Hemann's June 26, 2002 Order that required PwC to produce, among other things, all internal guidance referenced in PwC's workpapers. See, Exhibit 21.⁴¹ Telxon noted that "[f]rankly, we were led to believe that PwC was compiling these materials during the month it took to respond." See

actually on p. 1 of the letter.

³⁷ Third-Party Defendant PricewaterhouseCoopers LLP's Response to Third-Party Plaintiff Telxon Corporation's Second Request for Production of Documents, Pinney app. 2, Exh. 19.

³⁸ The quotation on page 9 should be "... PwC already has produced to Telxon all documents responsive to this Request."

³⁹ Exhibit 16 is a letter from Krantz and Speirs to Magistrate Judge Hemann, June 25, 2002, Pinney app. 2.

⁴⁰ Letter from Elliott to Miller, Carson, Bell, Martin Wymer, and Krantz, July 29, 2002; Pinney app. 2, Exh. 20, p. 2. The pieces of internal guidance provided were ASM 160; ARM 4650.32; FARM Section 70, paragraph 38; and AAR 1170.34.

⁴¹ Letter from Campagna to Porritt and Elliott, August 8, 2002; Pinney app. 2, Exh. 21.

Exhibit 21, pg. 1, ¶2.⁴²

27. Rather than complying with Magistrate Judge Hemann's June 26, 2002 Order, on August 9, 2002, PwC responded to Telxon, stating, "If you believe there are other references to PwC's internal guidance that have not been produced, please provide workpaper reference and we will look into it." See, Exhibit 22, pg. 1, ¶3.⁴³

28. On August 12, 2002, Telxon sent another letter to PwC, warning, "For the record, you have represented that PwC has reviewed its workpapers and has produced all materials referenced therein. If this is not an accurate statement of your representation, please advise immediately." See, Exhibit 23,⁴⁴ pg. 1, ¶2. PwC made this representation during a preceding telephone conference that I participated in with Maria Campagna (one of Telxon's attorneys).

29. On August 30, 2002, Class Plaintiffs sent PwC a list of internal guidance sections to be produced. See, Exhibit 24.⁴⁵ Class Plaintiffs generated this

⁴² The full paragraph reads:

With respect to those items specifically referenced in PwC's workpapers, your production is seriously deficient. Judge Hemann ordered that all materials referenced in the workpapers be produced. You have produced only a few such items. Frankly, we were led to believe that PwC was compiling these materials during the month it took to respond. We expect that these items can be readily compiled, and request that they immediately be made available for inspection and copying."

⁴³ Letter from Porritt to Campagna, August 9, 2002. The full paragraph reads:

With regard to the PwC materials referenced in the workpapers themselves, we believe the materials produced so far are complete. Based on our review of the workpapers, we are not aware of any additional portions of internal PwC or Coopers guidance that are specifically referenced in the workpapers in describing the work performed. If you believe there are other references to PwC's internal guidance that have not been produced, please provide workpaper reference and we will look into it.

⁴⁴ Letter from Campagna to Porritt, August 12, 2002; Pinney app. 2, Exh. 23.

⁴⁵ Letter from Speirs to Elliott, August 30, 2002; Pinney app. 2, Exh. 24. The letter also noted on pp. 3-4, "In addition, Plaintiffs state that it does not appear that PwC has produced all guidance referenced by its workpapers, as ordered by the Court. For just one

list from the indexes PwC had provided to Telxon and Class Plaintiffs on July 29, 2002.

30. On September 19, 2002, Telxon, Class Plaintiffs, and PwC held a conference call to discuss PwC's discovery failures, particularly PwC's continuing failure to comply with Magistrate Judge Hemann's June 26, 2002 Order. I participated in this conference call. Following the call, Telxon and Class Plaintiffs sent separate letters to PwC memorializing the call and demanding the production of all internal guidance referenced in PwC's workpapers. See, Exhibits 25⁴⁶ and 26,⁴⁷ respectively. As the letters evidence, PwC produced only four pieces of internal guidance. In violation of Magistrate Judge Hemann's June 26, 2002 Order, PwC refused to produce certain of its internal guidance manuals to Telxon and Class Plaintiffs. Telxon and Class Plaintiffs reluctantly agreed to "table" the issue of PwC's failure to produce all internal guidance referenced in its workpapers until after Telxon and Class Plaintiffs reviewed the internal guidance manuals that PwC said it would promptly produce. PwC also required that the internal guidance be restricted to "attorneys' eyes only" and attempted to require Telxon and Class Plaintiffs to advise PwC when the internal guidance would be shown to consultants or testifying experts.⁴⁸

example, there are numerous references to the Global TEQ Workbook in the workpapers; however, those referenced documents have not been produced."

⁴⁶ Campagna Sept. 19 letter.

⁴⁷ Sobel Sept. 19 letter.

⁴⁸ Plaintiffs actually acquiesced in these conditions and apparently believed that Telxon had as well. Sobel wrote on pp. 1-2:

Second, plaintiffs agree, as did Telxon, to accept the production by PwC of the selected portions of the manuals identified by plaintiffs and Telxon, on the condition that they be reviewed now on an 'attorneys' eyes only' basis. If and when plaintiffs desire to show those portions of the manuals to a consulting or testifying expert, we will advise PwC prior to doing so. . . .

Third, while we believe that the production of four pieces of professional literature is insufficient, in light of your belief that the selected portions of the PwC manuals will duplicate the guidance itemized in the work papers, we have agreed to table the issue for now. We have also agreed that should plaintiffs find professional literature identified in the work papers that are [sic] not encompassed in the manual portions, plaintiffs will not be precluded from requesting the production of that additional guidance.

31. On September 23, 2002, PwC produced the internal guidance sections specifically requested by Class Plaintiffs. See, Exhibit 27⁴⁹ and PWC 66174-67244. As indicated Class Plaintiffs based their selections on the indexes provided by PwC.

32. On October 15, 2002, Telxon, Class Plaintiffs, and PwC appeared before Magistrate Judge Hemann on a discovery dispute raised by PwC. The dispute between PwC and Telxon involved a single Telxon interrogatory response. In addressing the Court, PwC's counsel again represented to Magistrate Judge Hemann: "To my knowledge, every responsive document [of PwC] has been produced. I don't know of any that have not." See, Exhibit 28,⁵⁰ pg. 58, lines 17-20.

33. On October 23, 2002, Telxon sent another letter to PwC requesting compliance with Magistrate Judge Hemann's July 26, 2002 Order See, Exhibit 29.⁵¹ . . . Telxon . . . once again demanded production of "all portions of the C&L and PwC [internal guidance] manuals referenced in the work papers." The letter memorialized PwC's admission that it had not produced all referenced portions, but rather only those sections that were relevant in PwC's counsel's sole opinion. See,

Thus, plaintiffs went so far as to agree to identify internal guidance referenced in the workpapers which PwC had failed to produce and to "request" that PwC produce that guidance, rather than demanding that PwC comply with the order of the court.

⁴⁹ Letter from Elliott to Campagna, September 23, 2002; Pinney app. 2, Exh. 27. Elliott told Sobel:

These documents are provided for you in exchange for our mutual agreement that you will provide none of these documents to any consultant or expert witness prior to (1) informing PwC's counsel that you intend to do so and, [sic] (2) allowing PwC a reasonable opportunity to present its demand to the Court and resolution by the Court, for the identification of, and appropriate certification from, the consultant and/or expert whom you intend to produce such documents. As to any further requests for professional literature you have agreed to table such discussion to a time in the future in which you specifically identify any further literature, if any, that may be referenced in the PwC workpapers that are necessary to an understanding of the work performed in connection with the audits of PwC relating to the above-referenced cases. If this is not your understanding, please return these materials to me immediately.

⁵⁰ Transcript of Proceedings, October 15, 2002; Pinney app. 2, Exh. 28.

⁵¹ Letter from Bell to Porritt, October 23, 2002; Pinney app. 2, Exh. 29.

Exhibit 29, pg. 1, ¶5.⁵² . . .

34. On November 4, 2002, . . . PwC acknowledged its obligation to comply with Magistrate Judge Hemann's June 26, 2002 Order in . . . responding, "Sixth, [Magistrate] Judge Hemann's order regarding internal guidance related to internal policies or manuals as well as any internal guidance specifically referenced in the workpapers. PwC has fully complied with that order." See, Exhibit 30, pg. 2, ¶4.⁵³

Pinney aff. at 7-9.

In sum, PwC insisted for over four months that the court had ordered it to produce

⁵² This section reads in relevant part:

. . . Telxon has reviewed the limited production of practice and procedure manuals provided by PwC and finds the production inadequate. Magistrate Hemann, at the June hearing, ordered PwC to produce all portions of the C&L and PwC manuals referenced in the work papers. Nick [Porritt] has acknowledged that PwC has not produced all referenced portions and instead only produced those which, in his sole opinion, are "relevant" to understanding the work papers. This is not acceptable and not what the court ordered. All portions of the referenced manuals--which Nick has conceded would be the entire manuals--must be turned over.

⁵³ Letter from Porritt to Bell, November 4, 2002; Pinney app. 2, Exh. 30. Two paragraphs earlier, Porritt told Bell:

[T]he question of further production of PwC internal guidance was discussed on a conference call with Maria Campagna and Hilary [sic] Sobel on September 19, 2002. During that telephone call, PwC stated its view that it had produced the internal guidance it had identified following its review of the workpapers, where that guidance was expressly referenced in the workpapers in describing the work performed. We also discussed the fact that any other internal guidance that may be discussed in the workpapers should be included in the internal guidance for which indices were provided and from which both plaintiffs and Telxon have received the provisions they wanted. It was left that if either plaintiffs or Telxon identified some internal guidance referred to in a workpaper that had not been produced by PwC, then that party could request the production of that document and PwC would consider that request. See September 19, 2002 letter from Sobel to Porritt. Accordingly, we believe this issue has been resolved. If you have a specific workpaper in mind, please identify it and we will consider the request for production.

only those guidance materials referenced in the workpapers *and* essential to understanding PwC's audit. On November 4, 2002 it conceded that the court required it to produce any internal guidance specifically referenced in the workpapers. Today, PwC has returned to its original position, and it insists, "Consistent with the proceedings of June 26, 2002, PwC . . . produced all guidance materials cited in the text of PwC workpapers *that were necessary to an understanding of the work that PwC performed in its audits of Telxon.*" Def. opp. at 13 (emphasis added).

In fact, PwC never complied with *either* interpretation of the court's order. As Pinney noted:

35. On November 15, 2002, I sent PwC a letter requesting, among other things, PwC to produce additional internal guidance that I identified in PwC's workpapers during my review of those workpapers. See, Exhibit 31.⁵⁴ This internal guidance should have been produced by PwC to comply with Magistrate Judge Hemann's June 26, 2002 Order. My review of the workpapers identified dozens of references to internal guidance materials that PwC had not produced.

Pinney aff. at 9. In addition, as has already been described, in late November 2002 Pinney discovered that PwC had failed to produce ARM 9612.23, a piece of internal guidance which Pinney claims is critical to Telxon's case against PwC. See *supra* at 12-13. It was at this point that Pinney discovered the substitution of unrelated but similar pages of index with identical page numbers into the internal guidance index which would have referenced ARM 9612.23. Pinney requested this piece of internal guidance and the correct index pages in a letter dated November 26, 2002. See Letter from Pinney to Porritt, November 26, 2002; Pinney app. 2, Exh. 32.

⁵⁴ Letter from Pinney to Porritt, November 15, 2002; Pinney app. 2, Exh. 31.

When PwC failed to produce either the internal guidance requested on November 15, 2002 or the internal guidance requested on November 26, 2002, on December 18, 2002 Telxon wrote to demand that PwC respond to its outstanding requests for internal guidance materials. See Letter from Pinney to Porritt, December 18, 2002, Pinney aff., Exh. 33. PwC finally responded and produced the requested internal guidance and indices on January 14, 2003, *eight weeks* after the November 15, 2002 and *six weeks* after the November 26, 2002 request. See Letter from Elliott to Pinney, January 14, 2003; Pinney app. 2, Exh. 34.

As was revealed on June 21, 2003, even the much-belated January 14, 2003 production of internal guidance documents did not satisfy the court's order to produce all internal guidance referenced in the Telxon workpapers. Some of the previously-unproduced materials in the June 21, 2003 production included internal guidance accessed from workpapers view links and pop-ups. Pinney aff. at 16-19. Given PwC's behavior thus far, there is no reason whatsoever to believe that PwC has finally produced all internal guidance documents referenced in the Telxon workpapers.

The court's order on June 26, 2002, while not entirely unambiguous, was not difficult to construe. The court told the parties:

[T]o the extent that there are references to work papers, to policies, then indeed **you will produce those manuals**. And **in addition to that**, I want you to prepare a list that would satisfy that production. I want you to give it to Telxon. I want you to give it to Mr. Krantz. And I want them to be able to look at it and the three of you negotiate and work on what should be turned over.

June 26 tr. at 14. If PwC had been uncertain as to what the court was requiring it to

produce, it had only to ask for clarification to resolve the problem.⁵⁵ Instead, PwC argued interminably regarding the meaning of the court's order, dribbled relevant documents out in productions scattered over months, delayed its responses, and had still failed to comply with any reasonable interpretation of the court's order nearly a year later.⁵⁶ The substitution of similar, identically-numbered index pages for the correct index pages and attributing the substitution to an unexplained "clerical error" speaks for itself. See Letter

⁵⁵ It is worth noting that PwC has offered a third interpretation of what the magistrate judge's order meant. In the Declaration of Geoffrey F. Aronow, Appendix of Exhibits IB ("Aronow decl."; Docket # 311), Exh. G, p. 5, the declarant gives this understanding of the order:

In June 2002, Telxon and Class Plaintiffs requested that the Court resolve various discovery issues, including whether PwC should be required to produce its hard copy internal guidance manuals. The issue was addressed during a hearing with the Magistrate Judge, at which she directed PwC to make an index of internal guidance manuals available to the parties and allowed the Class Plaintiffs and Telxon to request that PwC copy and produce those portions of the guidance materials that the parties deemed relevant. The Magistrate Judge also instructed PwC to produce **critical** guidance materials cited in the text of PwC workpapers.

Aronow decl. at 5 (emphasis added) (citation omitted). The only way to arrive at this interpretation from what was actually said at the hearing is by transforming "to the extent that there are references to work papers, to policies, then indeed you will produce those manuals" into "to the extent that there are references to **critical** work papers, to policies, then indeed you will produce those manuals."

⁵⁶ Nor was this an isolated instance of PwC's failure to obey court orders timely. For example, on October 15, 2002 the court ordered PwC to produce to Telxon and plaintiffs whatever information it had as to which public or private business clients of Price, Waterhouse LLP, C&L, or PwC had restated their financial statements. Transcript of Proceedings, October 15, 2002; Pinney app. 2, Exh. 28, pp. 64-65. It did not require PwC to generate a complete list, merely to turn over what information it had on hand. Despite at least two reminders to comply with the court's order, PwC did not produce the required information until January 15, 2003. See Letter from Bell to Porritt, October 23, 2002; Pinney app. 2, Exh. 29; Letter from Pinney to Porritt, December 18, 2002; Pinney app. 2, Exh. 33; and Letter from Porritt to Pinney, January 15, 2003; Pinney app. 2, Exh. 36.

from Elliott to Pinney, January 14, 2003; Pinney app. 2, Exh. 34, p. 1.

For these reasons the court does not accept PwC's contention that PwC did not fail to produce any guidance material and that Telxon misstates Magistrate Judge Hemann's ruling of June 26, 2002.

5. *PwC promptly responded to document production issues raised in discovery but never realized that a second database existed.*

The court will not recite PwC's arguments in support of this assertion: they are both tiresome and beside the point. PwC began production of documents to the SEC on February 22, 1999. PwC told Telxon and plaintiffs that it produced the hard copies of the 1998 Telxon audit workpapers from the local server electronic database. At minimum, then, PwC invites this court to believe that for four years it did not realize that workpapers for the 1998 Telxon audit were electronically stored in an archive version *as was regularly done in the normal course of business*. The court declines PwC's invitation.

6. *PwC voluntarily agreed to produce its electronic databases and investigated differences between the electronic databases and its hard copy production on its own initiative.*

The court will not award PwC points for eventually exploring the possibility that there might be differences among its electronic databases when it ought to have done that four years earlier. Moreover, PwC's "voluntary" production was far from graceful. Faced with the reality of reckless bad faith behavior on its part, it sighed and acquiesced to plaintiffs' and Telxon's "needlessly time-consuming sideshow."

7. *PwC voluntarily disclosed detailed information about its supplemental production to the parties to facilitate their review of the supplemental documents.*

Even a cursory reading of PwC's description of its supplementary production, *supra* at 24-27, gives the reader the impression that PwC is attempting to "spin" its outrageous discovery failures rather than assist Telxon and plaintiffs. If PwC had sincerely wanted to help Telxon and plaintiffs, it would have produced requested information timely, thoroughly, and in the order in which the documents were kept in the ordinary course of business. It did not do any of these things.

D. Analysis

1. *Sanctions pursuant to R. 37(c), failure to disclose*

In the instant case, consideration of the *Regional Refuse* factors strongly supports the entry of default judgment as sanction. Most important, it would be difficult for anyone to argue that PwC's conduct over the course of this litigation, particularly in its repeated assurances to the court and to the parties that it had fully disclosed all relevant information, was not due to willfulness, bad faith, or fault. PwC failed at the start of discovery to check thoroughly its local servers and its archives for relevant documents, failed to compare the various versions of relevant documents on those databases, failed to produce documents as they were kept in the ordinary course of business, and failed to reproduce thoroughly and accurately all documents and their attachments. Prior to litigation PwC had permitted destruction of documents despite committing to their preservation. Despite these failures, PwC time and time again told the court and the parties that it had made a complete disclosure of all relevant documents and attachments and that it had produced them in the

order in which they were stored by PwC. The only conclusion the court can reach is that PwC and/or its counsel engaged in deliberate fraud or was so recklessly indifferent to their responsibilities as a party to the litigation that they failed to take the most basic steps to fulfill those responsibilities.

In some cases, it is difficult to avoid the conclusion that PwC engaged in deliberate fraud. For example, PwC claims that the 1998 audit papers were produced from a version of the papers contained on the hard drive of a laptop computer. Yet, this version of the 1998 workpapers does not contain documents from areas 100 and 300 of the audit, and PwC produced hard copies of documents from those areas in its initial production of the 1998 audit workpapers. One of three conclusions seems inescapable: (1) PwC actually produced the hard copies from a local server version of the documents, a version which PwC has not yet admitted exists; (2) PwC produced the hard copies from areas 100 and 300 of the archive version of the 1998 audit, and its supposed recent discovery of that version is pure fabrication; or (3) PwC produced the hard copies from the laptop version and then deleted those documents from areas 100 and 300. Any of these three courses of conduct would be sanctionable as fraud on the court.

As already described, Telxon and plaintiffs argue that they have been prejudiced by PwC's failure to cooperate in discovery in at least three ways: (1) PwC's failure to produce certain documents during discovery adversely affected Telxon's and plaintiffs' decisions as to whom to depose and which questions to ask deponents; (2) PwC's failure to produce all versions of relevant documents deprived Telxon and plaintiffs of the opportunity to examine how PwC's audit evolved and the timing, nature, extent, and

purpose of changes in the audit; and (3) PwC's failure to produce documents timely and in the order in which they were kept in the regular course of business slowed Telxon's and plaintiffs' discovery of relevant information and increased the cost of discovery. Telxon and plaintiffs also point out that (1) PwC's failure to protect documents from alteration when PwC was on notice to do so means that Telxon and plaintiffs have no assurance that the extant documents have not been modified to their injury; and (2) missing documents, missing attachments, missing metadata, and hard copies of documents in a version different from the versions on any of the electronic databases so far produced suggest that PwC may be withholding or has improperly destroyed discoverable information. Telxon and plaintiffs cite evidence to back each of these claims. The magistrate judge has heard PwC's explanations for apparently missing documents and metadata and for differences between hardcopy versions of documents and those on any of the electronic databases and finds that those explanations **may** explain these phenomena in whole or in part, but "may" is the operative conditioner here. Otherwise, the magistrate judge finds Telxon's and plaintiffs' arguments compelling.

Although neither PwC nor its attorneys were warned that failure to cooperate could lead to dismissal, this should have little weight in the court's deciding whether to impose default judgment given the number of discovery disputes and the magistrate judge's ongoing and active involvement in the disputes. Moreover, PwC is one of the "big four" accounting firms, and has had considerable experience with litigation.⁵⁷ PwC's counsel,

⁵⁷ PwC has been a party to the following decisions handed down in federal courts in this year alone: *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir.

Arnold & Porter, post at their website an introductory brochure which describes the law firm's experience with litigation as follows:

Our firm's approach can be seen most clearly in the way our lawyers litigate complex business disputes. More than half of our attorneys are actively engaged in litigation in federal and state courts. In addition to serving in all traditional litigation roles--from pre-trial discovery to trials to appellate advocacy--we frequently serve as national coordinating counsel for our clients, defending related cases in high-stakes litigation through networks of local counsel.

Arnold & Porter LLP, arnoldporter.com, p. 6. Telxon also notes that Arnold & Porter has represented PwC or its predecessor, C&L, in eight previous federal court cases. Tel. reply at 29 n.9. Local counsel for PwC, Benesch, Friedlander, Coplan & Aronoff LLP ("Benesch"), describes itself on its website as follows:

Benesch, Friedlander, Coplan & Aronoff LLP is an entrepreneurial law firm of more than 120 attorneys with offices in both Cleveland and Columbus, Ohio. . . . The firm's clients include public, middle market and emerging companies as well as public entities, entrepreneurs, non-profit organizations, trusts and estates.

"About Benesch," at bfca.com. The firm also describes its trial practice at its website:

Our trial attorneys actively pursue cost-effective outcomes in courtroom litigation and dispute resolution for clients that include multi-national and publicly held companies, private companies, public entities, boards, and individuals. On a daily basis our trial lawyers are involved in virtually every type of business dispute including, [sic] hostile takeovers and mergers, contract disputes, fraud issues, construction and real estate disputes, securities litigation, officer and director liability issues and unfair competition matters.

2004); *Tricontinental Indus., Ltd. v. Anixter*, 313 F. Supp. 2d 788 (N.D. Ill. 2004); *Grabow v. PricewaterhouseCoopers LLP*, 313 F. Supp. 2d 1152 (N.D. Okla. 2004); *In re ICN Pharmaceutical Securities*, 299 F. Supp. 2d 1055 (2004); *Lewin v. Lipper Convertibles L.P.*, 2004 WL 1077930 (S.D.N.Y. May 13, 2004) (and related cases, *CILP Assocs., L.P. v. Lipper Convertibles*, 2004 WL 1077991 (S.D.N.Y. May 13, 2004), and *VTech Holdings v. PricewaterhouseCoopers LLP*, 2004 WL 1064513 (S.D.N.Y. May 12, 2004)); *Crowley v. Chait*, 2004 WL 1385855 (D.N.J. March 16, 2004); and *Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, 2004 WL 112948 (S.D.N.Y. Jan. 22, 2004).

"Practice and Industry Groups: Trial," at bfca.com. PwC, Arnold & Porter, and Benesch know without warnings from this court what the penalties are for conducting discovery in bad faith--and must be deemed to know that their conduct in the instant litigation has been utterly inexcusable.

Finally, the magistrate judge has considered, but cannot recommend, any lesser sanction than the entry of default judgment against PwC. Lesser sanctions would result in "unwinding" over three years of litigation. This would require the re-taking of many depositions and the taking of new depositions, the conduct of additional expert analyses and the production of new reports, and the propounding of new interrogatories. But four considerations militate against this solution to the problem. First, beginning discovery again would mean additional lengthy delay before the case reaches a resolution. Telxon and plaintiffs have already suffered sufficient delay because of PwC's bad-faith conduct; to allow PwC's misbehavior to impose substantial new delays to reaching a resolution of this litigation would be unfair to Telxon and plaintiffs. Second, because PwC failed to archive the 1998 workpapers which are at the heart of this case until late January of 1999, those workpapers were vulnerable to undetectable alteration while the Telxon litigation was pending. The Ennis case in particular creates strong suspicions that this has been done to at least one document. Third, PwC's production of still more documents after April 21, 2004 undercuts any belief that PwC has now or will ever produce all relevant material in its possession. Fourth, and most critical, there is strong evidence that documents have been destroyed, placing plaintiffs and Telxon in a situation which cannot be remedied.

Because PwC's conduct has made it impossible to try this case with any confidence

in the justice of the outcome, PwC should bear the burden created by its conduct. For this reason the magistrate judge recommends that the court grant Telxon's and plaintiffs' motions and enter default judgment against PwC and in favor of Telxon and plaintiffs in cases 5:98CV2876 and 1:01CV1078.

2. *Sanctions pursuant to the inherent powers of the court*

As the Supreme Court advised in *Chambers*, "when there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power." *Chambers*, 501 U.S. at 50. Because the magistrate judge is recommending an entry of judgment against PwC for violations of R. 37(c), the court need not consider sanctions pursuant to its inherent powers.

IV.

For the reasons given above the magistrate judge recommends that the court grant Telxon's and plaintiffs' motions and enter default judgment on liability against PwC and in favor of Telxon in case no. 5:98CV2876 and against PwC and in favor of plaintiffs in case no. 1:01CV1078.

Date: July 16, 2004

/s/Patricia A. Hemann
Patricia A. Hemann
United States Magistrate Judge

OBJECTIONS

Any objections to this Report and Recommendation must be filed with the Clerk of Courts within ten (10) days of receipt of this notice. Failure to file objections within the

specified time waives the right to appeal the District Court's order. See *United States v. Walters*, 638 F.2d 947 (6th Cir. 1981). See also *Thomas v. Arn*, 474 U.S. 140 (1985), *reh'g denied*, 474 U.S. 1111 (1986).